

INCOME TAX MANUAL

Ministry of Finance

Islamic Republic of Afghanistan

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INTRODUCTORY COMMENTS

This Income Tax Manual is issued under the authority granted to the Ministry of Finance by Article 113(2) of the Income Tax Law of 2005. The purpose of this Income Tax Manual is to provide additional guidance to the Afghanistan Revenue Department and others regarding the interpretation and application of the Income Tax Law of 2005. While particular reference is made to the Afghanistan Revenue Department throughout this Manual, that term should be read as meaning and including revenue offices in the mustofiat.

In reviewing the Income Tax Manual, the reader should understand that all legal and natural persons are considered to be residents of Afghanistan unless otherwise noted. In addition, any references to accounting terms including, but not limited to, “revenue”, “gross profit”, “operating expenses” and “net profit” are to generally accepted accounting concepts. These concepts are addressed and defined by the International Accounting Standards Board. Until Afghanistan develops its own accounting standards, the Afghanistan Revenue Department shall accept the use of terminology and standards set forth by the International Accounting Standards Board.

In this manual, each Article of the Income Tax Law is given separately, followed immediately by the regulations pertaining to that Article. The income tax laws as variously amended are referred to as the Law. The provisions of the Law are incorporated in the manual and made a part of the regulations.

Each regulation is identified by a reference number. The first part of the reference number identifies the Article of the Law which is explained by the regulation. The second part of the reference number identifies each separate explanation of the Article.

These rules and regulations should be carefully read and studied to the end that we may have a fair, uniform, and consistent application and enforcement of the Law. The rules as written must be followed and the taxes collected as set forth. No change or alteration can be made unless authorized by the Ministry of Finance. Instructions, directions, and forms are considered to be a part of the regulations.

No one sentence, rule or regulation states all the Law. The entire rule must be considered in its application to a certain situation. All rules and regulations must be considered together and taken as a whole to determine the construction and interpretation of the Law.

The reader should also understand that the Income Tax Manual is only one of several sources of additional guidance. More detailed guidance regarding specific Articles of the Income Tax Law may also be found in procedures, guides, policy statements and rulings. The reader is also encouraged to visit the Ministry of Finance’s website, www.mof.gov.af/tax, to obtain additional information about income tax laws in Afghanistan.

د افغانستان اسلامي جمهوریت
د مالیې وزارت



جمهوری اسلامی افغانستان
وزارت مالیه

Islamic Republic of Afghanistan
Ministry of Finance

Finance Circular No. 1 / 1385

دفتر وزیر

شماره (ع) ۱۷۰ - ۱۱۱۶

(Minister's Office)

No: ()

Subject: Ministerial Authorization of the Income Tax Manual

In accordance with paragraph 2 of Article 113 of the Income Tax Law 2005, I hereby endorse the Income Tax Manual 2006, which has been approved by the review committee of the Department of Revenue.

From the date of this circular, all officers of the Government of Afghanistan charged with the administration of the Income Tax Law 2005 shall abide by the interpretation and application of the provisions of the Income Tax Manual.

I hereby order that the Income Tax Manual be published and distributed by the Revenue Department in such manner that the Revenue Department considers appropriate. This includes website publication.

This circular comes into effect on the date it is signed.

Dr. Anwar Ul-Haq Ahady
Minister of Finance
Islamic Republic of Afghanistan

CHAPTER I

GENERAL PROVISIONS

Article 1 - Article 11

Authority

Article 1 This Law is imposed under the authority of Article 42 of the Constitution of Afghanistan for the purpose of tax determination and tax payment.

1.1 Article 42 of the Constitution of Afghanistan (1382) provides that:

Every Afghan is obligated to pay taxes and duties to the government in accordance with the provisions of law.

No taxes and duties are enforced without the provisions of law.

The rate of taxes and duties and the method of payment are determined by law on the basis of observing social justice.

This provision is also applied to foreign individuals and agencies.

Every kind of tax, duties, and incomes collected shall be delivered to the State account.

This law was approved by the Council of Ministers and subsequently endorsed by the President of the Islamic Republic of Afghanistan on 14 November 2005. The law came into effect from that date. The enactment of this law is in accordance with the Constitution of Afghanistan.

1.2 This Income Tax Manual is issued under the authority granted to the Ministry of Finance by Article 113(2) of the Income Tax Law of 2005. The purpose of this Income Tax Manual is to provide additional guidance to the Afghanistan Revenue Department and others regarding the interpretation and application of the Income Tax Law of 2005.

Tax Implementation

Article 2. (1) A tax is imposed on the income from Afghan sources of all natural persons, corporations, limited liability companies, and other legal entities whether in Afghanistan or abroad, and on the foreign income of residents of Afghanistan in accordance with the provisions of this Law.

(2) A natural or legal person is considered a resident of Afghanistan in the following circumstances:

1. The person has his or her principal home in Afghanistan at any time during the fiscal year; or
2. The person is present in Afghanistan for a period or periods amounting to one hundred eighty-three days in the fiscal year; or
3. The person is an employee or official of the Government of Afghanistan assigned abroad at any time during the fiscal year.
4. Any other entity is resident in Afghanistan for a fiscal year if it was established in Afghanistan or has the centre of its administrative management in Afghanistan at any time during the year.

2.1 The following definitions shall apply for the purpose of this Income Tax Manual:

a. A “corporation” is a legal entity:

1. incorporated under a firm name;
2. for any commercial or industrial purpose not prohibited by law;
3. having a determined basic capital represented by negotiable share certificates;
4. whose liabilities shall be satisfied only by the assets of the corporation; and
5. in which the liability of shareholders shall be limited to the unpaid amount of their subscribed shares.

b. A “limited liability company” is a legal entity:

1. incorporated under a firm name;

2. having a determined basic capital represented by non-negotiable partners' certificates;
3. whose liabilities shall be satisfied only by the assets of the limited liability company and
4. in which the liability of its partners is limited to the amount of their subscribed capital unless the company's articles of incorporation or the laws of Afghanistan specifically provide for greater liability.

2.2 A natural person's "principal home" is determined using a facts and circumstances test. In determining whether a natural person has a "principal home" within Afghanistan, the following factors shall be taken into account:

1. whether the natural person owns or rents the home in Afghanistan;
2. whether the natural person owns or rents a home in a different country;
3. the amount of time the natural person spends in Afghanistan and the amount of time the natural person spends in other countries;
4. the location of the natural person's family; and
5. the length of time the natural person has owned his or her home in Afghanistan and the length of time that the natural person has owned a home in one or more other countries.

Example 1. *Azizi owns a home in Bamiyan province. Azizi also rents an apartment in Uzbekistan. Azizi spends half of his time in Bamiyan and half of his time in Uzbekistan during the year. The fact that Azizi purchased a home in Afghanistan, but only rents a home outside of Afghanistan suggests that Azizi's "principal home" is in Afghanistan.*

Example 2. *Azizi owns a home in Kabul City. Azizi also owns a home in Tajikistan. Azizi spends more time in Tajikistan than he spends in Kabul. Azizi's principal home is not in Afghanistan.*

Example 3. *Azizi owns a home in Bamiyan province. Azizi has owned the home for three years. Azizi recently purchased a home in Uzbekistan. Azizi spends an equal amount of time at his home in Bamiyan province and his home in Uzbekistan. Because Azizi has historically owned his home in Afghanistan, and all other factors are neutral, Azizi's principal home is in Afghanistan. If, in the subsequent year, Azizi spent more time in Uzbekistan and less time in Afghanistan, then Azizi's principal home would not be in Afghanistan.*

Example 4. *Azizi rents an apartment in Kabul City. Azizi also rents an apartment in Tajikistan and Pakistan. Azizi stays at his Kabul City apartment for 150 days during the year. He spends 107 days in his apartment in Tajikistan. He spends 108 days in his apartment in Pakistan. Azizi's principal home is in Afghanistan.*

Example 5. *Azizi rents an apartment in Kabul City where he, his wife and three children stay. Azizi also owns an apartment in Karachi, Pakistan. Azizi spends most of his time during the year working in Pakistan. His wife and children remain in Kabul City. The fact that Azizi's family continues to reside in Afghanistan suggests that Azizi's principal home is in Afghanistan.*

- 2.3 A legal entity is considered to be resident in Afghanistan if the legal entity is formed under the laws of Afghanistan.

Example: *Company A is an entity that is registered as a corporation under Afghan commercial law. Company A's board of directors holds all of their meetings outside of Afghanistan. Company A's president lives and works outside of Afghanistan. Company A is a "resident" of Afghanistan.*

- 2.4 A legal entity can also be considered to be resident in Afghanistan if the "centre of its administrative management" is within Afghanistan. Whether a legal entity shall be considered to have the "centre of its administrative management" in Afghanistan will be determined based on a facts and circumstances test. In making this determination, the following factors should be considered:

1. Whether the managers of the entity are physically present in Afghanistan when making decisions on behalf of the legal entity.
2. The number of decisions made by the managers while physically present in Afghanistan compared to the number of decisions made by the managers while physically present outside of Afghanistan.
3. Whether the managers of the entity are residents of Afghanistan.

Example 1. *A corporation is formed in Tajikistan. The corporation has three directors. One of the directors is an Afghan resident. The other two directors are residents of Tajikistan. The directors hold four meetings every year. One meeting is held in Kabul City. Three meetings are held in Tajikistan. The centre of the corporation's administrative management is not in Afghanistan.*

Example 2. *A corporation is formed in Tajikistan. The corporation has three directors. Two of the directors are Afghan residents. The other director is a resident of Tajikistan. The directors hold four meetings*

every year. Two meetings are held in Kabul City. Two meetings are held in Tajikistan. The centre of the corporation's administrative management is in Afghanistan.

Tax (Fiscal) Year

Article 3.

- (1) The income tax is imposed for each taxable year on the taxable income of each person, corporation, limited liability company, or other entity. The taxable year is the solar year which starts from the first day of Hamal (21 March) and ends on the last day of Hoot (20 March).
- (2) A legal person wishing to use a different taxable year than that mentioned in paragraph (1) of this Article shall apply, in writing, to the Ministry of Finance setting out the reasons for the change of that person's taxable year to another twelve-month period. The Ministry of Finance may approve such application but only where the application is justified.
- (3) A taxable year approved under paragraph (2) of this Article takes effect from the date specified by the Ministry of Finance by notice in writing.
- (4) The Ministry of Finance is authorized to withdraw the approval prescribed in paragraph (3) of this Article when required.

- 3.1 The income tax applies to income within a defined period which is the solar year. Except as is provided in Article 3(2) of the Income Tax Law, the taxable year begins on the first day of Hamal and ends with the last day of Hoot of the same year.
- 3.2 Because the Income Tax Law uses an annual accounting concept it does not matter when a person earns his or her income during the year. Thus, a legal person that earns Afs. 12,000 in one month and does not operate during the other 11 months of the taxable year will have to pay the same amount of tax as a legal person that earns Afs. 1,000 per month for twelve (12) months.
- 3.3 Income belonging to one taxable year may not be included in the income of another taxable year. If a person starts a business during the latter part of one taxable year and continues the business into the following taxable year, the income from the business shall not be combined in computing the person's tax, even though the person may have conducted the business for twelve (12) months or less in total.

Example: *A company starts a business in the last three months of 1384 and continues the business for nine additional months in 1385. The company has no business for the last three months of 1385 nor did it have any other income during 1384 and 1385. Although the company's business was conducted for a total period of 12 months, the company's income was earned in two taxable years. Therefore, the company's tax for each of the years is computed separately. Thus, the company's business income earned in the three months of 1384 is the company's taxable income for 1384; and the business income in the nine months of 1385 is company's taxable income for 1385.*

- 3.4 Article 3(2) allows a legal person (but not a natural person) to apply, in writing, to the Ministry of Finance for a different taxable year than the standard fiscal year and for the Ministry to grant such an application where the reasons for it are regarded as justifiable.
- 3.5 The Ministry of Finance will regard an application for an alternative taxable year as justifiable where:
- (1) a legal person in Afghanistan is a subsidiary organization of a parent organization established outside Afghanistan in a country with a different taxable year,
 - (2) where that parent organization prepares consolidated financial statements for tax purposes in that foreign country, and
 - (3) requiring the legal person in Afghanistan to prepare its financial statements on the basis of the Afghanistan fiscal year would impose significant additional tax compliance costs for that legal person.
- 3.6 The Ministry of Finance will regard an application for an alternative taxable year by a legal person as not justifiable where the only reason for the application is because the employees of the legal person are paid on a different pay period basis than the fiscal year. The additional tax compliance costs faced by employers in such situations are not regarded as significant enough to warrant the Ministry of Finance having to recognize a different taxable year for the employer (or its employees).
- 3.7 In any situation where a request for an alternative accounting year is regarded by the Ministry of Finance as justifiable, the Ministry will inform the legal person of this in writing (according to Article 3(3) of the Law) setting out the commencement date of the change and expected tax payment dates which will be determined by the Ministry to ensure that neither the legal person nor the Government of Afghanistan obtains an unduly favourable tax position as compared with payments by other taxpayers.

Tax Calculation

Article 4.

- (1) The income tax of legal persons is 20 percent of its taxable income in the fiscal year.
- (2) Income in foreign money shall be converted to afghanis for purposes of taxation. The rate of conversion shall be the average of free rates used by Da Afghanistan Bank to purchase such foreign money at the end of each month.
- (3) The income tax of a natural person is the amount calculated in accordance with the following schedule:

TAXABLE INCOME			INCOME TAX	
From	1 Afs	Up to Afs	12,500 per month	0%
From	12,501 Afs	Up to Afs	100,000 per month	10%
From	100,000 Afs		per month	In addition to afs 8,750
				20%

- 4.1 The amount of income tax for a natural person is calculated by applying the schedule in Article 4 (3). Where total taxable income for a month is Afs 12,500 or less, no tax is payable. Where total taxable income is more than Afs 12,500, then only the amount which exceeds Afs 12,500 will require tax to be paid.

For example, the tax on Afs. 1,500,000 of annual taxable income for a natural person is computed as follows:

0%	first Afs. 12,500 per month	(150,000 per year)	Afs.	0
10%	on the next Afs. 87, 500 per month	(1,050,000 per year)	Afs	105,000
20%	On the amount over 100, 000 per month	(over 1,200,000 per year)	Afs	60,000
Tax on Afs. 1,500,000			Afs.	165,000

Remark: The schedule of tax rates applies to natural persons. It does not matter whether taxable income is derived from salary or wages or from business activities.

- 4.2 "Income in foreign money" means income received in foreign currency. Even if foreign currency is received, the taxpayer shall compute his or her tax liability in Afghanis.

Example: According to the terms of a contract, a salary of USD \$500.00 per month is payable to an individual taxpayer. The average free rate of exchange is \$1:50Afs. in the first month and \$1:52Afs in the second month. The individual's income in the first and second month is as follows:

First Month: $\$500 \times 50 = 25,000$ Afghanis

Second Month: $\$500 \times 52 = 26,000$ Afghanis

Although the amounts are paid in U.S. dollars, the individual must

translate these amounts so that he or she can compute his or her tax liability in Afghanis.

Remark: *In the absence of a free rate of exchange, the cash buy rate used by Da Afghanistan Bank may be used.*

- 4.3 Income in foreign exchange is required to be converted to afghanis. The established rate at which DaAfghanistan Bank buys currency (the 'cash buy' rate) shall be used for the purpose of conversion. If DaAfghanistan Bank does not have an established exchange rate for a foreign currency, the foreign income is to be converted into afghanis in the following manner:
- a. Based on the market value of the foreign exchange in the country where it was received at the time it was received, the foreign exchange in question is converted to U.S. dollars or another currency in which Da Afghanistan Bank trades.
 - b. The figure so obtained in terms of U.S. dollars or other currency is then converted into afghanis.

Example: *A resident of Afghanistan residing abroad earns 30,000 Canadian dollars in the tax year, but DaAfghanistan Bank does not have an established separate rate for Canadian dollars. The market value of the U.S. dollar in that country, when the income was received, was 1.14 Canadian dollars, and the price paid for U.S. dollars by DaAfghanistan Bank in Kabul was Afs. 50 during the same period. The income of the person in terms of afghanis is computed as follows:*

Step 1: Change Canadian dollars to U.S dollars, that is: \$26,315
30,000\1.14

Step 2: Convert US dollars so obtained to afghanis: 26,315
x Afs. 50 *Afs.1,315,750*

Tax on Residents

Article 5. (1) Tax on income of resident natural persons in Afghanistan shall be calculated as follows:

1. In accordance with taxable income including income from sources outside Afghanistan.
2. Any income tax paid to the government of a foreign country by a resident natural person of Afghanistan may be taken as credit only against that part of his annual income tax attributable to his foreign income.
3. If the income of a resident natural person is derived from more than one foreign country, the income tax credit shall be applied in proportion to the income from each country as provided in the Income Tax Manual established by the Ministry of Finance.

(2) All legal persons are subject to income tax on all taxable income from all sources within Afghanistan and outside Afghanistan according to the provisions paragraph (1) of this Article.

5.1 An Afghan resident is subject to taxation under the Income Tax Law, even if the income is attributable to services performed outside of Afghanistan.

Example: An Afghan resident has written a series of articles for magazines and newspapers while stationed abroad. His income from these articles is subject to income tax in Afghanistan even though the activities that generated the income were performed outside of Afghanistan.

5.2 An Afghan resident may claim a credit for foreign income taxes paid subject to the limitation provided in Regulation 5.3 of this Manual.

5.3 The foreign tax credit referred to in Article 5.2 of this Manual is subject to a "per country" limitation. The limitation for each country is calculated as follows:

- a. The total amount of income (i.e., revenue minus applicable expenses) generated by the taxpayer in the country that imposed the foreign tax is determined. This figure shall be referred to as the taxpayer's "Foreign Source Income."
- b. The total Afghan income tax, before any applicable credit, is determined.
- c. The total Afghan income tax is multiplied by a fraction. The numerator of the fraction is the taxpayer's Foreign Source Income. The denominator of the fraction is the taxpayer's income from all sources around the world.

Example: An individual resident in Afghanistan has taxable income from Afghanistan of Afs. 2,000,000 and taxable income from foreign country A of Afs. 500,000 (after conversion). The Afghan income tax attributable to his total taxable income of Afs. 2,500,000 from all sources worldwide is Afs. 365,000. His foreign income tax liability accrued and paid to country A is Afs. 100,000.

1. Maximum credit allowable for country A:

$$\frac{\text{total Afghan income tax}}{\text{Afs. 365,000}} \times \frac{\text{country A's taxable income Afs. 500,000}}{\text{total taxable income worldwide Afs. 2,500,000}}$$

= Afs. 73,000 maximum limit of income tax credit allowable

2. Assume that the income from outside of Afghanistan was Afs. 300,000 from country B with income tax liability of Afs. 60,000 paid and Afs. 200,000 from country C with an income tax liability of Afs. 25,000. The maximum limit of income tax credit for each country is computed as follows:

- a. Maximum credit for country B:

$$\frac{\text{total Afghan income tax}}{\text{Afs. 365,000}} \times \frac{\text{country B's taxable income Afs. 300,000}}{\text{total taxable income worldwide Afs. 2,500,000}}$$

= Afs. 43,800 maximum limit of income tax credit allowable for country B.

Remark: The excess credit from income tax paid to country B of Afs 16,200 cannot be carried forward or back to offset or reduce income tax payable on taxable income from country B in future or prior years.

- b. Maximum credit for country C:

$$\frac{\text{total Afghan income tax}}{\text{Afs. 365,000}} \times \frac{\text{country C's taxable income Afs. 200,000}}{\text{total taxable income worldwide Afs. 2,500,000}}$$

= Afs. 29,200 maximum limit of income tax credit allowable for country C

The amount of income tax paid in country C is Afs. 25,000. As this amount does not exceed the maximum limit, the amount of Afs 25,000 may be claimed as a credit.

Remark: No part of the excess credit from income tax paid to country B of Afs 16,200 can be added to the credit for income tax paid to country C.

5.4 The foreign income tax credit shall be allowed only if:

1. A copy of the income tax return and the tax receipt from the country imposing the tax is submitted with the Afghan return.
2. All income from all sources is included in the Afghan income tax return.

3. No deduction has been taken for the foreign income tax claimed as a credit.
 4. The other country's tax is a tax that is imposed on net income as required by Regulation 5.5 of this Income Tax Manual.
- 5.5 The credit for foreign tax paid is for income taxes only. The credit is not allowed for foreign taxes that are not imposed on a taxpayer's income. Whether a tax is imposed on income is determined by looking at all of the facts and circumstances. In making this determination, the Afghanistan Revenue Department should consider whether or not the foreign country permits the taxpayers to claim a reasonable amount of deductions from the taxpayer's revenue.

Example 1: *A citizen of Afghanistan doing business abroad pays customs duties on imports of goods sold in his/her business. Such duties are considered part of his/her cost of goods sold, but the duties cannot be used as a credit against the individual's Afghan income tax liability.*

Example 2: *A citizen of Afghanistan doing business abroad pays a four percent turnover tax in a foreign country amounting to Afs. 22,000 in the taxable year. His net income tax paid in that country is Afs. 1,600 for the same year. The turnover tax of Afs. 22,000 can be deducted as an expense item. The turnover tax cannot be claimed as a credit against Afghan income tax liability. Only the net income tax paid abroad, Afs. 1,600, may be claimed as a credit, and reduce the corporation's Afghan tax liability.*

Example 3: *Company A is an Afghan corporation that does business in Afghanistan and Pakistan. Company A is in the business of manufacturing and selling furniture. Company A is subject to a tax in Pakistan. Assume that Pakistan imposes a 2% tax on Company A's revenue minus its cost of goods sold. Although the Pakistani tax permits Company A to claim a deduction for cost of goods sold, the Pakistani tax is not a tax on income. The Pakistani tax is not a tax on income, because the tax fails to permit Company A to deduct its operating expenses, like wage expense and depreciation expense.*

Remark: *Taxes that are not imposed on income can nevertheless be considered deductible business expenses, but they are not allowed as a credit.*

Non-residents Tax Exemptions

Article 6. Non-resident persons are exempt from income tax provided that the foreign country grants a similar exemption to residents of Afghanistan.

- 6.1 Example: *A pilot or other person performing services in aircraft in the airspace above Afghanistan is exempt from income tax in Afghanistan if all of the following conditions are met:*
- a. he/she is an alien;*
 - b. his/her employer is a foreign company or government;*
 - c. he/she is not residing in Afghanistan;*
 - d. his/her government or employer's government does not tax Afghans in a comparable situation.*

Non-residents and Allowable Deductions

Article 7. (1) Individuals, companies and other non-resident persons not engaged in trade or business in Afghanistan are subject to income tax on the amount received from sources within Afghanistan as interest, dividends, rents, royalties, and gain or profit of any kind according to the provisions of this Law.

(2) Deductions allowed under this Law are only allowed in respect of income other than interest, dividends, rents and royalties to those non-resident legal persons which file a true and accurate return including all information required by this Law and the Income Tax Manual established by the Ministry of Finance.

- 7.1 Certain amounts received by a non-resident are subject to withholding under Article 46 of the Income Tax Law. This withholding does not establish the taxpayer's liability under the Income Tax Law, however.

Example: *Feroz is an individual that is resident in Canada. Feroz receives Afs. 100,000 interest income from an Afghan corporation. The interest income is subject to 20% withholding under Article 46 of the Income Tax Law. Because Feroz earned less than Afs. 150,000 during the year, Feroz is not subject to tax in Afghanistan under Article 4 (Afs. 12,500 per month x 12 months = Afs. 150,000). Feroz can file an income tax return and claim a refund for the Afs. 20,000 that was withheld.*

- 7.2 A non-resident natural or legal person may claim deductions to reduce his or her income from Afghan sources if the income is not considered interest, dividends, rents or royalties. If a non-resident legal or natural person does not file a return, however, the Afghanistan Revenue Department may assess tax on the taxpayer's gross income.

Example 1: *A Turkish corporation operates a restaurant in Kabul. The Turkish corporation operates the restaurant as a branch. It does not choose to form a new Afghan corporation to conduct the restaurant operations. During the first year of operation, the restaurant generates Afs. 10,000,000 of revenue, but incurs Afs. 7,000,000 of deductible expenses. The Turkish corporation does not file an income tax return. The Ministry of Finance will be entitled to assess the Turkish corporation tax of Afs. 2,000,000 or 20% x Afs. 10,000,000.*

Example 2: *A Turkish corporation operates a restaurant in Kabul. The Turkish corporation operates the restaurant as a branch. It does not choose to form a new Afghan corporation to conduct the restaurant operations. During the first year of operation, the restaurant generates Afs. 10,000,000 of revenue, but incurs Afs. 11,000,000 of deductible expenses. The Turkish corporation does not file an income tax return. The Ministry of Finance will be entitled to assess the Turkish corporation tax of Afs. 2,000,000, even though the Turkish corporation*

did not generate a profit during the year.

Example 3: *A Turkish corporation operates a restaurant in Kabul. The Turkish corporation operates the restaurant as a branch. It does not choose to form a new Afghan corporation to conduct the restaurant operations.*

(a) During the first year of operation, the restaurant generates Afs. 10,000,000 of revenue, but incurs Afs. 13,000,000 of deductible expenses. The Turkish corporation does not file an income tax return. The Afghanistan Revenue Department within the Ministry of Finance will be entitled to assess the Turkish corporation tax of Afs. 2,000,000 in the first year, even though the Turkish corporation did not generate a profit during the year.

(b) In the second year of operation, the restaurant generates Afs. 11,000,000 of revenue, and incurs Afs. 8,000,000 of expenses. In the second year of operation, the Turkish corporation files an income tax return. The tax return shows Afs. 3,000,000 of profit, reduced by a Afs. 3,000,000 net operating loss carried forward from the first year of operation. The tax return filing is improper. Because the Turkish corporation failed to file a tax return in the first year, no portion of the first year net operating loss may be carried forward to offset the taxable income in the subsequent year.

Tax on Business Activities

- Article 8. (1) Non-resident natural persons, companies and other organizations engaged in economic, service or business activities in Afghanistan are subject to income tax on all taxable income from sources within Afghanistan.
- (2) Deductions are allowable only if and to the extent that they are connected with income from sources within Afghanistan.
- (3) Income derived from the operation of aircraft and its staff under the flag of a foreign country are exempt from taxation provided that the foreign country grants a similar exemption to aircraft and its staff under the flag of Afghanistan.
- (4) A correct apportionment of expenses with respect to sources of income within Afghanistan shall be determined as provided by this Law and the Income Tax Manual.
- (5) Where a non-resident person carries on business in Afghanistan through a branch in Afghanistan, the taxable income of the branch is determined as if the branch were a separate legal person and calculated as follows:
1. payments or amounts incurred to another part of the non-resident person are deemed to be dividends under paragraph (3) of Article 13 of this Law,
 2. no deduction is allowed for payments or amounts incurred to another part of the non-resident person according to paragraph (2) of Article 18 of this Law, and
 3. expenses incurred by the branch or another part of the non-resident person that related directly to the earning of gross income by the branch are treated as expenses incurred by the branch as a separate legal person.

- 8.1 A non-resident legal or natural person is subject to Afghan tax on all income from Afghan sources.

Example 1: *An Afghan subsidiary of a foreign corporation purchases goods from its parent foreign corporation. To finance an exceptionally large purchase, the subsidiary borrowed US\$100,000 from the parent company. The loan bears interest at a rate of six per cent. The interest expense is deducted by the subsidiary corporation in determining its net income. This expense is income of the foreign corporation from sources in Afghanistan, and is subject to a tax of 20 per cent. The payer must withhold tax pursuant to Article 46.*

Example 2: *An individual that is not resident in Afghanistan owns all of the stock of a subsidiary in Afghanistan. The subsidiary was capitalized with Afs. 100,000. The Afghan subsidiary generated Afs. 1,000,000 of profit during its first year of operation. The subsidiary distributes Afs. 1,050,000 to its sole shareholder during the year. Of this distribution,*

Afs. 1,000,000 is treated as a “dividend” within the meaning of Article 45 of the Income Tax Law. As such, the distribution is subject to withholding of Afs. 200,000. The corporation must withhold the tax under Article 46. The remaining Afs. 50,000 distribution is considered a return of invested capital, and is not subject to Afghan tax.

Example 3: *A French corporation licenses certain rights to use telecommunications technology to an Afghan corporation in exchange for a yearly royalty. The French corporation and the Afghan corporation are unrelated to each other. The royalty is computed as 5 percent of the Afghan corporations’s net sales every year. Net sales for the first year were Afs. 1,000,000. Five percent of 1,000,000 equals 50,000. Thus, the royalty is subject to tax of 20 percent of 50,000 or Afs. 10,000. The licensee must withhold tax under Article 46.*

8.2 Payments of Afghan source income to a partnership are deemed to be made to the partnership’s partners.

Example 1. *Wahid is an Afghan resident individual. Jack is a citizen of the United Kingdom. Wahid and Jack form an Afghan partnership to conduct business in Kabul City. Wahid owns 20% of the partnership. Jack owns 80% of the partnership. During the course of their business, the partnership makes a loan to an unrelated Afghan corporation. The partnership earns Afs. 800,000 of interest on the loan in the first year. Because the interest is paid by an Afghan corporation, it is considered to have an Afghan source. The Afghan borrower will have to withhold tax equal to 20% of that amount, or Afs. 160,000. Eighty percent, or Afs. 128,000, is allocable to Jack, a UK person. The balance is allocable to Wahid.*

Example 2. *The facts are the same as in Example 1, except that Wahid and Jack own a UK limited liability partnership, not an Afghan partnership. The results are the same.*

8.3 Income of a foreign airline derived from operations in Afghanistan is subject to taxation under the Income Tax Law unless the government of the country under whose flag the foreign airline operates grants a reciprocal exemption from taxation to citizens or companies of Afghanistan.

8.4 Income received by foreign airline companies from sales in Afghanistan or from business originating in Afghanistan is subject to taxation. If the taxable income from such operations cannot be determined from the records of the company, the Ministry of Finance may, in proportion to its activities in Afghanistan, allocate a portion of the company’s worldwide profits during the taxable year to its activities in Afghanistan.

8.5 A registered foreign trader may in fact be a branch of a foreign corporation or limited liability company. The actual circumstances and facts, not appearances, must govern determinations by the Ministry of Finance. If a foreign company has a branch operating in Afghanistan, it is doing business in Afghanistan and its profits from sales in Afghanistan are taxable. Criteria for distinguishing an independent trader from a branch of a corporation or limited liability company include:

<u>Independent Trader</u>	<u>Branch of Company</u>
a. Has no salary from company, depends on mark-up for income.	Employees of company receive salaries or commissions from company.
b. Company has no investment in business of trader.	Office equipment, office space, etc., belong to the company.
c. Company has no control of trader. Contract or franchise agreement may control the activities of a trader.	Company can discharge representatives or employees of branch or can close the branch.
d. Trader purchases from foreign company and sells to his customers.	Branch does not purchase from company, but obtains orders from customers to be filled by the company.
e. Imports usually belong to the trader before sale to the customers.	Imports belong either to the company or the customer.
f. Trader may be extended credit by foreign company.	No need for credit. Any credit extension is to customers.
g. Usually handles products of many different companies.	Usually handles only the products of the home office.

Careful review of the method of operation and the relationship of the trading establishment to the company is necessary before any determination of its nature can be made. The criteria listed above are indicative, not conclusive. Other aspects may shed light on the question of its being an arm of a foreign corporation or limited liability company, thereby bringing that corporation or limited liability company under provisions of Article 8 of the Income Tax Law.

Example 1. A Pakistani corporation produces bottled water and sells the bottled water in Kabul using an Afghan resident as its representative. The Afghan resident is not considered an employee of the Pakistani corporation. The Pakistani corporation tells the Afghan resident the price that must be charged for each bottle of water. The Pakistani corporation also tells the Afghan resident where the water may be sold. The Afghan resident receives a commission based on the number of bottles that the Afghan resident sells. The Afghan resident is entitled to sell bottled water produced by other corporations. The Afghan resident is an independent trader. The Pakistani corporation does not have a branch in Afghanistan, because the Afghan resident does not receive a fixed salary and is not restricted to selling one type of water.

Example 2. The facts are the same as in Example 1, but the Afghan resident is prohibited by contract from selling bottled water produced by any of the Pakistani corporation's competitors. The Afghan resident is not an independent trader. The Pakistani corporation should be considered as having a branch within Afghanistan.

8.6 A foreign corporation or limited liability company selling its products in

Afghanistan through persons who are employees of the foreign corporation or limited liability company, is subject to taxation on profits derived from its sales in Afghanistan.

Example. A Pakistani corporation sends one of its employees to Afghanistan to sell products manufactured by the Pakistani corporation. The employee actually solicits sales while he is physically present in Afghanistan. When a sale is made, the Pakistani corporation ships products directly from Pakistan to the customer in Afghanistan. The activities of the Pakistani employee constitute a “branch” of the Pakistani corporation. The profits attributable to the branch are subject to tax in Afghanistan.

- 8.7 If the books of a foreign company engaged in business in Afghanistan are not kept so as to show its taxable income derived from its activities in Afghanistan separately from that derived from its activities in other countries, then the Ministry of Finance shall allocate part of its taxable income from its world-wide activities to its activities in Afghanistan. The taxable income of such a company that can be attributable to its activities in Afghanistan is computed as follows:

Step 1: The gross income of the company from its world-wide activities, as shown by its latest report or financial statements, is determined.

Step 2: After the deductions of Chapter II of the Income Tax Law, its net income before taxes from world-wide activities is computed.

Step 3: The amount of taxable income (computed in step 2) is divided by the gross income (determined in step 1). The quotient so determined is the percentage of profit from its world-wide activities.

Step 4: The total gross income from its activities in Afghanistan is multiplied by the percentage of profit (determined in step 3). The product so obtained will be its gross income before taxes from its activities in Afghanistan.

Example: A foreign company which owns heavy construction equipment is engaged in several countries in the business of leasing such equipment to persons and other companies. This foreign company signs a contract under which it leases some of its heavy construction machinery to persons and companies located in Afghanistan for Afs. 6,000,000. The books of the foreign company do not show its operating expenses in Afghanistan. Instead, its books show Afghan expenses along with the operating expenses of the company in several countries. The taxable income of this company can be determined as follows:

Step 1: The gross income of the company from its world-wide activities is determined from the latest profit and loss statement of the company. Assume this figure is Afs. 25,000,000.

Step 2: Using the exemptions and deductions of Chapter II of the Income Tax Law, the taxable income (net income before taxes) from its world-wide activities is computed. Assume this figure is Afs. 2,500,000.

Step 3: *The taxable income from the world-wide activities, namely Afs. 2,500,000, is divided by gross income from the world-wide activities, namely Afs. 25,000,000. The quotient so determined is the percentage of profit from its world-wide activities, namely:*

$$2,500,000 \div 25,000,000 = 0.1 = 10\%$$

Step 4: *The total gross income of the company from its activities in Afghanistan, namely, Afs. 6,000,000, is multiplied by 10 per cent, that is, the percentage of the profit of the company from its world-wide activities. The product so obtained is the amount allocated as the taxable income of the company from its activities in Afghanistan, namely:*

$$10\% \times \text{Afs. } 6,000,000 = \text{Afs. } 600,000$$

Step 5: *The taxable income from Afghanistan of Afs. 600,000 is multiplied by 20 per cent (the tax rate for companies). The tax for the company which is payable to Afghanistan, is:*

$$20\% \times \text{Afs. } 600,000 = \text{Afs. } 120,000 \text{ tax}$$

- 8.8 As a general rule, a foreign corporation or limited liability company is considered to be doing business in Afghanistan if it has a place of business or permanent establishment in Afghanistan. A foreign company is considered not to be doing business in Afghanistan if its sales are to a broker, an independent dealer, an agency of the State, etc., or if it has no permanent establishment in Afghanistan.

If the foreign corporation or limited liability company is doing business in Afghanistan, its income from such business is taxable. If it is not doing business in Afghanistan, its income from business with Afghanistan is not taxable.

For the purpose of taxation under the Income Tax Law:

- a. A place of business is defined as follows:

A place of business is the place in which the business of the enterprise is wholly or partly carried on.

- b. Any one the following shall be considered to be a permanent establishment:
1. a place of management;
 2. a branch;
 3. a factory;

4. an office;
 5. a workshop;
 6. a warehouse;
 7. a mine, quarry, or other place of extraction of natural resources;
 8. a construction, installation or assembly project;
 9. a permanent sales exhibition; and
 10. a wholly or partly owned subsidiary, provided that this subsidiary is an enterprise in Afghanistan, that a foreign company participates directly or indirectly in the management, control or capital of the enterprise, or the same persons participate directly or indirectly in the management, control, or capital of the enterprise and a foreign company, and if in either case such conditions are made or imposed between the two in their commercial or financial relations that differ from those which would be made between independent companies.
- c. A person acting in Afghanistan on behalf of a foreign company shall be deemed to constitute a permanent establishment of that company in Afghanistan if any one of the following conditions are met:
1. He/she has and commonly exercises in Afghanistan an authority to conclude contracts in the name of the foreign company.
 2. He/she commonly maintains in Afghanistan a stock of goods or merchandise from which he/she regularly delivers goods or merchandise for or on behalf of the foreign company.
 3. He/she commonly secures orders in Afghanistan exclusively or almost exclusively for the foreign company itself, or for other companies which are controlled by it or which have a controlling interest in it. This provision shall apply regardless of whether such orders are placed in the name of the representative or directly by another middleman or ultimate purchaser.

Example 1: *A Japanese corporation manufactures replacement auto parts. The Japanese corporation asks an Afghan resident to solicit orders for these parts from mechanics and garages in Afghanistan. The Afghan resident travels throughout Afghanistan. When the Afghan resident finds a mechanic or garage that is interested in purchasing the auto parts, the Afghan resident will prepare a contract for the supply of these parts to the mechanic or the garage. The Afghan resident and the mechanic will negotiate price and terms, and the Afghan resident and the mechanic will sign the contract. The Japanese corporation should be considered to have a permanent establishment in Afghanistan by virtue of the Afghan resident's*

activities.

Example 2: *A Japanese corporation manufactures replacement auto parts. The Japanese corporation asks an Afghan resident to solicit orders for these parts from mechanics and garages in Afghanistan. The Afghan resident travels throughout Afghanistan. When the Afghan resident finds a mechanic or garage that is interested in purchasing the auto parts, the Afghan resident will ask the mechanic if he is interested in entering into a supply contract. The Afghan resident and the mechanic will negotiate price and terms, and the Afghan resident will then send the contract to the Japanese corporation for review and approval. If the Japanese corporation approves the contract, an employee of the Japanese corporation will execute the contract (not the Afghan resident). The Japanese corporation should not be considered to have a permanent establishment in Afghanistan due to the Afghan resident's activities.*

Tax on foreign Governments and International Organizations

Article 9. The taxability of income in Afghanistan of foreign governments, international organizations, and of their employees not residents of Afghanistan shall be determined by the provisions of existing agreements, treaties and protocols with the government of Afghanistan.

- 9.1 Salary and wages of an Afghan resident are subject to taxation regardless of the identity of the employer.

Example 1: Salary or wages of an Afghan resident employed by a foreign embassy in Kabul is taxable in Afghanistan.

Example 2: Salary or wages of an Afghan resident employed in Afghanistan by a foreign organization that has been granted immunity from taxation by treaty or contract with the State is taxable even though the treaty or contract grants exemption to foreign employees of the organization.

- 9.2 Salary or wages of a citizen of a foreign country employed by his/her government in Afghanistan are exempt if one of the following conditions exist:

- a. a treaty between that government and Afghanistan provides for exemption;
- b. international law, custom, or usage so dictates.

Example: Income of foreigners from their employment in Afghanistan as members of a diplomatic mission of their country is not subject to taxation.

- 9.3 The income of an alien who is employed in Afghanistan by a foreign organization and paid by its own government shall be treated in the same way as the income of aliens employed directly by that government on the same project is treated.

Tax Exempt Organizations

Article 10. (1) Contributions received and income from the necessary operations of organizations that meet the following conditions are exempt from taxation:

1. The organization must be established under the laws of Afghanistan.
2. The organization must be organized and operated exclusively for educational, cultural, literary, scientific, or charitable purposes.
3. Contributors, shareholders, members or employees either during the operation or upon dissolution of the organization mentioned in sub-paragraphs 1 and 2 of this paragraph must not benefit from the organization.

(2) The process of exemption from income tax for organizations prescribed in paragraph (1) of this Article shall be provided in the Income Tax Manual.

10.1 An organization meeting the qualifications set forth in Article 10 of the Income Tax Law is exempt from taxation under that Law. However, the organization cannot itself determine that it qualifies for such exemption. The Ministry of Finance determines this from facts set forth in the Application for Exemption and from other information available. If the Ministry of Finance issues an unfavorable determination, the taxpayer may appeal to the court and the court will determine whether the requirements are satisfied. The application for exemption from taxation shall be submitted to the Ministry of Finance on the form contained in the appendix to this manual (Application for Tax Exemption) or obtained from the tax information page on the Ministry of Finance website (<http://www.mof.gov.af/tax/>). The form shall be submitted in triplicate. After a determination of the status of the applicant has been made by the Ministry of Finance, the forms shall be distributed as follows:

- one copy returned to the applicant
- one copy retained by the Ministry of Finance
- one copy sent to the tax office which has jurisdiction over the applicant.

10.2 Just as a government enterprise is not exempt from income taxes, so an established commercial enterprise owned by an organization qualifying for exemption under Article 10 of the Income Tax Law is not exempt.

Example 1: *An Afghan corporation is formed to operate a school solely for educational purposes. The corporation receives donations and*

provides education to elementary school children for free, or at substantially low rates. The school happens to own a bookstore which sells books to both students and non-students. The bookstore competes with other bookstores in the surrounding area. The managers of the bookstore seek to operate the bookstore at a profit. Although the operation of the school may be exempt from taxation, the bookstore is not exempt.

Example 2: *A charitable institution (tax exempt under Article 10) owns most of the shares in an Afghan industrial corporation. Though controlled by the charitable institution, the income of the Afghan industrial corporation is taxable. The dividends received by the charitable institution from the Afghan industrial corporation are also taxable.*

Remark: *The Afghan industrial corporation is entitled to claim a deduction for dividends paid to the charitable institution so long as withholding tax has been paid on those dividends.*

Tax Exemptions of Government

Article 11. The income of agencies and departments of the State and of municipalities is exempt from taxation. Government enterprises are excluded from the provisions of this Article.

- 11.1 Though wholly owned by the Government of Afghanistan, the Central Bank is a Government enterprise and so its income from commercial operations is subject to income tax and to the business receipts tax.
- 11.2 Commercial or proprietary ventures (such as restaurants, hotels, etc.) of the Government or of its municipalities are considered "Government enterprises" and are not exempt from taxation under the Income Tax Law. Each venture must submit a balance sheet of its commercial operations and thus pay both the business receipts tax and the income tax in the same manner as privately owned ventures of the same nature.

Example: An agency of the State owns and operates a hotel, from which in the year 1384 it receives income from the rent of rooms, sale of food, catering services, souvenirs, postcards, etc., totaling Afs. 1,925,000. Of this total, Afs. 1,522,000 was from rent of rooms and Afs. 403,000 was from sales of supplies from its gift shop. In the same year, deductible operating expenses totaled Afs. 1,590,000. The agency of the State must pay the following taxes for its hotel operation:

Business Receipts Tax:

a) 10% of Room Rental Receipts (Afs 1,522,000)	152,200
b) 2% of Sales of Gift Shop Items (Afs. 403,000)	8,060

<i>Business Receipts Tax</i>	<i>160,260</i>
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Income Tax:

Total Income	1,925,000
Operating Expenses	(1,590,000)
Income Before Business Receipts Tax	335,000
Less: Business Receipts Tax	(160,260)
Net Taxable Income	174,740

<i>Income Tax (20% of net taxable income)</i>	<i>34,948</i>
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CHAPTER II

DETERMINATION OF TAXABLE INCOME

Article 12 – Article 20

Definitions

Article 12. Taxable Income is the total of all receipts of an individual, corporation, limited liability company, or other legal person less those exemptions and deductions authorized in this Law.

Exemptions are deductions from income of the taxpayer given in accordance with the provisions of this Law.

Deductions are expenses of production, collection, and preservation of income, which are allowed, by provisions of this Chapter, to be deducted from receipts.

Expenditures and costs not specifically defined as exemptions or deductions are not deductible.

Net Operating Loss is the amount that exceeds income after allowance of deductions prescribed in this Law.

- 12.1 Except as provided in the Income Tax Law, no expenditure may be subtracted from the income tax itself. Article 5 of the Income Tax Law provides for deduction of foreign income taxes paid on foreign income from the income tax due on such foreign income under the Income Tax Law of Afghanistan.

Except for foreign taxes, which are deductible from the tax itself, all other deductible expenses are deducted from income, and not from the Afghan income tax that is otherwise due.

- 12.2 Personal expenses are not deductible in computing taxable income.

Example 1: An Afghan resident operates a restaurant in Kabul. The Afghan resident chose not to form a corporation or limited liability company to own the restaurant. The resident employs a waiter, named Azizi, and a cook, named Asad. The Afghan resident pays each of Azizi and the cook Afs. 100 per day. The resident also pays his son, Farhiha, Afs. 80 per day. Farhiha occasionally visits the restaurant, but he does not wait tables or cook any food. The Afghan resident may only deduct Afs. 200 per day as wages expense. The Afs. 80 paid to Farhiha each day are not deductible expenses. Because Farhiha does not actually work at the restaurant, the amounts paid to him represent personal expenses that cannot be deducted.

Example 2: An Afghan resident operates an electrical supply store in Kabul which sells generators and switches and electrical adaptors. The Afghan resident decides to purchase a large electrical generator. The resident does not offer the large electrical generator for sale to the public. The resident does not use the generator as a backup generator to power the lights in his store. Instead, the resident uses the generator to power the lights and stoves in his house. The cost of the generator cannot be deducted against the income of the business. The amounts paid for the generator represent personal expenditures that cannot be deducted.

12.3 The Business Receipts Tax, Customs Duty, and any other tax (other than the Income Tax imposed under the Income Tax Law itself) can be deducted or added to the cost of an asset.

- (a) A tax can qualify as a business expense that is deductible from gross receipts if the taxes were incurred pursuant to the conduct of a business and do not relate to the acquisition of a specific asset.

Example 1: An Afghan resident operates a restaurant through which he provides food and beverages for immediate consumption within his establishment. The Afghan resident generates 1,300,000 Afghanis of revenue in his first year of operation. Because the restaurant generated more than Afs. 100,000 of revenue per month, the Afghan resident is subject to the business receipts tax in Article 64(2) of the Income Tax Law. The applicable rate of business receipts tax for services is 10% under Article 65(1)6. The restaurant also incurred Afs. 700,000 of operating expenses during its first year of operation. The Afghan resident's taxable income is therefore calculated as follows:

Assessable Income	1,300,000
Less: Business Receipts Tax	(130,000)
Subtotal	1,170,000
Less: Deductible Expenses	(700,000)
Taxable Income:	470,000
Income Tax (20%)	94,000

Example 2: Azziz is an Afghan resident that owns all of the issued stock of an Afghan corporation. The Afghan corporation imports certain raw materials like screws, bolts, glue, and upholstery, that the Afghan corporation uses to produce furniture. The imports are subject to import duty. The Afghan corporation can deduct these import duties, because they were incurred in the course of conducting the Afghan corporation's business of manufacturing furniture.

Example 3: Azziz imports various DVDs and compact disks from Pakistan and India for his personal use. Azziz pays import duties on these imports. The duties are not deductible from gross receipts in computing Azziz's tax liability.

- (b) If the tax was incurred to acquire an asset and the tax is not allowed to be claimed as a deduction, the tax must be added to the cost of acquiring the asset.

Example: Company A is an Afghan corporation that imports trucks which it uses in its transportation business in Afghanistan. Company A has to pay import duties with respect to the trucks. The import duties have to be added to the cost of the trucks. The import duties are not allowable as an income tax deduction. (But note a deduction by way of depreciation will be allowable under Article 18(1)7).

Receipts Subject to Tax

Article 13 (1) The following receipts are subject to income tax:

1. salaries, wages, fees and commissions,
2. all receipts derived from business and industry,
3. receipts from sale of movable and immovable property,
4. interest, dividends, rents, royalties, awards, prizes, winnings, bakhshishis (gratuities, bonus payments),
5. distributive shares of partnership gross income,
6. any other return from labor, capital, or economic activity,
7. income from other circumstances provided in this Law.
8. any other income which has not been provided in this Law.

(2) Dividends mean any distribution by a company in money or in property and any benefit provided to shareholders in their capacity as shareholders including:

- (1) any tangible or intangible assets;
- (2) shares in the company;
- (3) discounts on any purchases from the company;
- (4) loans to shareholders
- (5) the use of any company property.

(3) Where a branch in Afghanistan of a non-resident person (as defined in Article 8 of this Law) pays or incurs an amount to the non-resident person or any person connected to the non-resident person, that amount will be treated as a dividend.

13.1 A receipt does not have to be in the form of currency, coin, or money to be subject to taxation. The fair market value of property in whatever form or kind received as compensation is taxable income to the recipient.

Example 1: *An Afghan resident owns and operates an electrical supply store in Kabul. The store sells electrical generators, switches and basic appliances. Normally, the resident only accepts cash as payment. Once, however, the resident accepted a used car as payment for an electrical generator that typically sold for Afs. 60,000. Even though the resident did not receive cash, the resident is treated as having received the equivalent of Afs. 60,000.*

Example 2: *An Afghan resident operates a small carpet store in Kabul. The store sells a variety of carpets that are manufactured throughout*

Afghanistan. The Afghan resident employs 10 people. One of the employees, Azziz, does a very good job during the year selling carpets and providing customer service. The Afghan resident decides to pay Azziz an Afs. 10,000 bonus, over and above his normal wages for the year to compensate him for his efforts. Even though the Afs. 10,000 bonus is a bakhshishi, Azziz must include the amount in his income during the year.

Example 3: *An Afghan resident operates a restaurant in Kabul City which provides Afghan cuisine to customers. One of the resident's waiters is Wahid. Wahid earns Afs. 100 per day working at the restaurant, but also receives tips and gratuities from the people that eat at the restaurant. Wahid must include the gratuities in his income during the year even though the amounts are in excess of his normal wages.*

- 13.2 When an Afghan resident receives a debt instrument, or note, in exchange for services or property, the face amount of the debt or note shall be presumed to equal its fair market value. Nevertheless, if the interest rate on the debt or note is substantially above or below market, the fair market value of the note shall be determined by looking at what the appropriate interest rate on the note should have been if the interest rate used were a market rate based on all of the relevant facts and circumstances. The rules under Article 102 may be used to determine what a market rate of interest is.

Example: *An Afghan resident ("Seller") sells a car to another Afghan resident ("Buyer") for a five-year note with a face amount of Afs. 1,000,000 and bearing an interest rate of 5%. The note has a payment schedule as follows:*

<i>Year One</i>	<i>Afs. 230,974.80</i>
<i>Year Two</i>	<i>Afs. 230,974.80</i>
<i>Year Three</i>	<i>Afs. 230,974.80</i>
<i>Year Four</i>	<i>Afs. 230,974.80</i>
<i>Year Five</i>	<i>Afs. 230,974.80</i>

The payments are amortized as follows:

<u>Year</u>	<u>Payment</u>	<u>Interest</u>	<u>Principal</u>	<u>Balance</u>
1	230,974.80	50,000	180,975	819,025
2	230,974.80	40,951	190,024	629,002
3	230,974.80	31,450	199,525	429,477
4	230,974.80	21,474	209,501	219,976
5	230,974.80	10,999	219,976	-0-
	<u>1,154,874.00</u>	<u>154,874</u>	<u>1,000,000</u>	

The Seller has a cost basis of Afs. 800,000 in the car. The Seller reports Afs. 200,000 of gain with respect to the car in year one, and has to recognize interest as shown in the above table, assuming the payments are made promptly on the note each year.

Upon audit, and based on a review of the facts and circumstances, the Afghanistan Revenue Department determines that a market rate for the note would have been only 2%. Because the true market rate of interest was lower than 5%, the actual value of the note was higher

than its face amount of Afs. 1,000,000. The true value of the note was really Afs. 1,088,690 and the note would amortize as follows:

<u>Year</u>	<u>Payment</u>	<u>Interest</u>	<u>Principal</u>	<u>Balance</u>
1	230,974.80	21,774	209,201	879,489
2	230,974.80	17,590	213,385	666,104
3	230,974.80	13,322	217,653	448,452
4	230,974.80	8,969	222,006	226,446
5	230,974.80	4,529	226,445	-0-
	<u>1,154,874.00</u>	<u>66,184</u>	<u>1,088,690</u>	

As a result of the audit, the Seller would have to recognize gain of 288,690, an increase of Afs. 88,690 over what was reported on the Seller's tax return. This increase reflects the fact that the note was really worth more than what the Seller reported. The Seller would recognize interest income each year as set forth in the foregoing schedule assuming the payments are made promptly on the note each year.

- 13.3 Partners of a partnership must recognize the partnership's income or loss as it accrues under the partnership's method of accounting.

Example. *Azziz and Wahid are Afghan residents that are partners in a partnership. Azziz owns 60% of the partnership and Wahid owns 40% of the partnership. The partnership generates Afs. 1,000,000 of profit in its first year. Azziz must recognize Afs. 600,000 and Wahid must recognize Afs. 400,000 on their income tax returns.*

Remark: *Unlike corporations and limited liability companies, partnerships are not required to use the accrual method of accounting. See Article 37 and guidance issued pursuant thereto. If, however, a partnership chooses to use the accrual method of accounting, the partners are required to recognize their distributive share of the partnership's income using the accrual method.*

- 13.4 The receipt of cash or property by a legal entity in exchange for the issuance of equity interests in that entity is not considered taxable income to that entity.
- If a corporation, limited liability company, or partnership issues stock or partnership interests to a person in exchange for property, the issuance of stock or partnership interests shall be neutral to the corporation, limited liability company or partnership that issued the stock or the interest. The person transferring the property, however, will have to recognize gain or loss unless the transferor's gain is excluded from income under Article 14.
 - If a corporation or limited liability company issues stock to an existing shareholder or partner as a dividend, the dividend shall be neutral to the issuing corporation or limited liability company. The recipient will not be taxed on the receipt of the dividend, but will have a zero cost basis in the shares or interest received. This basis must be aggregated with the basis in the shareholder or partner's existing shares in order to compute an average stock basis.

Example 1: Two Afghan residents, Azziz and Wahid, own all of the issued stock of an Afghan corporation in equal shares. The corporation generated Afs. 100,000 of profit in the first year of operation. The corporation chooses to distribute Afs. 50,000 to Azziz, and 10 additional shares to Wahid in lieu of cash. The Afs. 50,000 received by Azziz is a taxable dividend. The 10 additional shares received by Wahid is not taxable, but Wahid takes the shares with a Afs. 0 cost basis. The earnings of the corporation are decreased by Afs. 50,000. There is no effect on the corporation from issuing the 10 additional shares.

Example 2: In 1384, an individual purchased 100 shares of stock in a corporation at a total cost of Afs. 3,600. In 1385 the corporation declared a stock dividend and the individual received 20 additional shares. His average cost is Afs. 30 per share. The additional shares do not constitute taxable income in 1385 unless the individual sells them in 1385. If he keeps all of the new shares in 1385 and sells some or all of the new shares in 1386, the proceeds from the sale must be declared as income in 1386. If he sells 50 shares for Afs. 40 a share and receives Afs. 2,000, his gain is Afs. 500 and is reportable as income.

<u>Individual's Stock Record and Costs</u>					
Purchased	1384	100	shares @ Afs. 36 per share	Afs.	3,600
Stock Dividend	1385	20	shares @ Afs. 0 per share	Afs.	0
120 shares @ average cost of Afs. 30 per share				Afs.	3,600
Sold 1386 50 shares @ Afs. 30 per share				Afs.	1,500
Remaining After Sale 70 shares @ avg. cost of Afs. 30 per share				Afs.	2,100

<u>Computation of Gain on Sale</u>					
Sold	1386	50	shares @ Afs. 40 per share	Afs.	2,000
Cost		50	shares @ Afs. 30 per share	Afs.	- 1,500
Gain reportable as income				Afs.	500

- c) If a corporation or limited liability company issues stock or partnership interests to an employee as compensation, the corporation, or limited liability company shall be entitled to a deduction equal to the value of the stock issued in the same year that the employee recognizes the value of the stock or partnership interest as a receipt. The employee will only recognize the value of the stock or partnership interest as a receipt in the year when the stock is not subject to a substantial risk of forfeiture. A share of stock is subject to a substantial risk of forfeiture if there are real and meaningful restrictions on the holder's ability to sell or transfer the stock.

Example 1: Two Afghan residents, Azziz and Wahid, form an Afghan corporation to operate a farm. Azziz and Wahid each own 50 percent of the corporation. They agree to hire Adib to manage their farm for them. To compensate Adib, the corporation pays Afs. 100 per day of work and 10 shares of stock at the end of the harvest. The 10 shares of stock are unrestricted. Adib can sell the shares to whomever he wants. The shares are worth Afs. 10,000. Adib must recognize and report as receipts Afs. 100 per day that he works plus the value of the shares that he receives (Afs. 10,000) at the end of the year. The corporation is entitled to deduct the Afs. 100 per day that it pays Adib plus the value

of the shares that it issues to Adib (Afs. 10,000).

Example 2: *The facts are the same as in Example 1, except that the shares that Adib receives are subject to a number of restrictions. Specifically, Adib cannot sell any of the shares for three years. Moreover, if Adib ceases to be an employee of the corporation at any time during the next three years (because his employment is terminated or because he quits) the shares will be forfeited and will revert to the corporation. In this case, Adib does not have to recognize the value of the shares in the year that they are issued. The corporation cannot claim a deduction for the value of the shares when they are issued. If, after three years, Adib remains an employee of the corporation and the restrictions are lifted, Adib will have to recognize the value of the shares at that time. Thus, if the shares are worth Afs. 12,000 in the third year, Adib must recognize Afs. 12,000. The corporation will be entitled to a deduction of Afs. 12,000 in the same year.*

13.5 The taxation of stock options differs depending on whether the stock option is issued as compensation for services or for property.

- a) Stock options that are issued as compensation are not subject to tax unless or until they are exercised. The corporation that employs the individual is not permitted to claim a deduction unless or until the employee recognizes the income associated with the exercise of the stock option.

Example: *An officer of a corporation exercises a stock option privilege which, under the terms of his employment, allows him to purchase a specified number of shares of stock of the corporation each year at a favorable price. The difference between the market value of the stock on the day he acquired it and the amount which he paid for it must be declared as income. Thus, if the officer purchased 10 shares of stock at Afs. 500 per share, and the market price of the stock was Afs. 750 per share on the day he acquired the stock, he must report the difference (Afs. 7,500 – Afs. 5,000 = Afs. 2,500) as income in the year in which he acquired the stock. The corporation is entitled to a deduction of Afs. 2,500 in the same year.*

- b) The tax consequences of stock options that are issued for property are held “open” until the option is exercised or lapses.

Example 1. *Azziz is an Afghan resident that owns a car which he purchased for Afs. 100,000 three years ago. Azziz now wants to sell the car. Wahid likes the car and wants to purchase the car, but he does not have the money at the present time. Azziz offers Wahid an option to purchase the car at any time during the next twelve months for a price of Afs. 80,000. Wahid pays Azziz Afs. 10,000 for this option. Six months later, Wahid exercises the option and pays Azziz Afs. 80,000. Wahid takes the car with a cost basis of Afs. 90,000. Azziz recognizes receipts of Afs. 90,000 (Afs. 80,000 price + Afs. 10,000 option premium). Azziz therefore has a 10,000 loss on the sale of his car (Afs. 100,000 cost base – Afs. 90,000 proceeds).*

Example 2. *The facts are the same as in Example 1, except that Wahid does not exercise the option. At the expiration of the option's term, Wahid has lost Afs. 10,000. Wahid may not deduct the Afs. 10,000 unless the Afs. 10,000 represent a business expense. See Articles 13 and 19. Azziz must recognize the Afs. 10,000 as income when the option lapses, because Azziz received Afs. 10,000 but was not required to transfer any cash or property in return when the option expired.*

- 13.6 A dividend may be taxable to the shareholders even though it is not formally declared. A dividend includes any benefit that a corporation confers on a shareholder to the extent that the corporation has sufficient earnings.

Example 1. *Naqibullah owns all of the issued stock of an Afghan corporation. The corporation has accumulated Afs. 10,000,000 in earnings. The corporation operates two car rental centers. One center is in Kabul and another is in Mazar-e-Sharif. The center in Mazar-e-Sharif allows Naqibullah's son, Azziz, to use its rental cars whenever he wants without paying for them. The manager of the Mazar-e-Sharif center estimates that the rents foregone equal Afs. 100,000 per year. Naqibullah will be considered to receive a deemed dividend from his Afghan corporation of Afs. 100,000.*

Example 2. *Naqibullah owns all of the issued stock of an Afghan corporation. The Afghan corporation purchases television sets from abroad and sells them to customers in Afghanistan. The television sets normally sell for Afs. 10,000. Occasionally, Naqibullah will purchase a set from one of his stores for Afs. 8,000. Every time that Naqibullah purchases a television set for Afs. 8,000, Naqibullah will be considered to have received a distribution of Afs. 2,000. If the corporation has sufficient earnings, the distribution will be considered a dividend. Otherwise, the distribution will be considered a tax-free return of invested capital or a capital gains distribution.*

Remark: *See Article 43 and the regulations promulgated pursuant thereto for the consequences to a corporation that distributes appreciated property to its shareholders.*

- 13.7 Any distribution by a company, whether in money or property or any other benefit, to a shareholder will be treated as a dividend. The distribution must be received by the shareholder in the person's capacity as a shareholder. If the distribution is provided for any other reason unrelated to the person's capacity as a shareholder, then the distribution will not be treated as a dividend.

Example 1: *Azeem is a shareholder of Kabul Construction Corporation. An earthquake damages the block of apartments where Azeem and other unrelated people live. As an act of charity, Kabul Construction Corporation agrees to repair the building for no cost. Even though Azeem has received a benefit ie the repair of his accommodation from Kabul Construction Corporation, he has not received that benefit because he is a shareholder in Kabul Construction Corporation. Rather, Azeem has received the benefit as a resident of the block of*

apartments. The value of the repairs to Azeem's apartment will not be deemed to be a dividend.

Where a benefit is provided to a shareholder in a form other than cash, the benefit will be treated as a dividend to the extent that the shareholder receives the benefit for less than its market value.

Example 2: *Bashir is a shareholder of Ace Electrical Company. The company sells electrical goods to the public. The shareholders are allowed to buy goods from the store for 25 percent of their market value (which is less than the cost of the goods). For the year 1385, Bashir buys goods with a market value of Afs 10,000 from the store and makes payment of Afs 2,500. Bashir has received tangible property from the company for less than market value because he is a shareholder of the company. Bashir therefore has received a dividend from the company. The amount of the dividend is the market value of the goods he has received less the amount he has paid. Therefore, Bashir will have received a dividend of Afs 7,500 in the 1385 year.*

This principle will apply to all forms of benefit received by a shareholder in their capacity as a shareholder for less than the market value to the public. Any tangible or intangible assets or shares in the company provided to a shareholder will be treated as a dividend to the extent that the shareholder has not paid market value. Loans by the company to shareholders will be treated as a dividend to the extent that the shareholders benefit from the conditions of the loan more concessional than loans provided by commercial banks to their customers.

Example 3: *Fayez is a shareholder of Hotel Safrini Corporation. Because he is a shareholder, he receives a loan of Afs 200,000. Fayez is required to repay Afs 202,000 after one year ie the amount of the loan plus 1 percent interest. If Fayez had taken the loan from a commercial bank, the amount to be repaid after one year would have been Afs 210,000 ie the amount of the loan plus 5 percent interest. Fayez has received a benefit less than market value. The benefit will be treated as a dividend. The amount of the dividend will be the amount of interest saved because of the favourable interest rate provided by the company. The amount treated as a dividend is the difference between the interest payable if the loan was taken with a commercial bank and the interest payable to the company ie Afs 8,000.*

If a shareholder is entitled to use company property on terms more favourable than available to the general public ie free of charge or at a discounted rate, then the use of the company property will be treated as a dividend to the extent of that favourable treatment.

Example 4: Aref is a shareholder of Avid Car Rental Company. The company conducts the business of hiring cars to customers. Cars are available for hire at the rate of Afs 2,000 per day. Aref takes a car for five days to travel from Kabul to Jalalabad to visit his family. Because Aref is a shareholder, he pays Afs 1,000 per day for the hire of the car. Aref has received a benefit from the company in his capacity as shareholder of the company. The benefit is treated as a dividend. The value of the benefit is the difference between market value and the amount Aref paid ie Afs 2,000 less Afs 1,000 equals Afs 1,000 a day. The value of the benefit for 5 days is Afs 5,000.

- 13.8 When a non-resident person owns a branch in Afghanistan, and that branch pays or incurs an amount to the non-resident person or to a person that is “connected” (within the meaning of Article 102 of the Income Tax Law) to that non-resident person, the payment will be considered a distribution from the branch to that non-resident person. In making the determination of whether a payment has been made, due regard shall be given to the books and records of the branch. If a branch operation generates profits during the year, and those profits are not reflected as earnings on the balance sheet at the end of the tax year, a dividend will be deemed to have been distributed. This deemed dividend will be subject to all applicable withholding taxes.

Example 1. Kashif is an individual resident of Pakistan that operates an import-export business within Afghanistan. Kashif has chosen to operate his import-export business as a branch, not a corporation. At the beginning of the year, the balance sheet for the branch is as follows:

Assets:		Liabilities:	
Cash	1,000,000	Accounts Payable	1,000,000
Receivables	8,000,000		
Inventory	10,000,000	Equity:	
Office Furniture	50,000	Equity Investment	10,000
		Earnings	18,040,000

During the year, the corporation does not generate any earnings. The balance sheet for the branch at the end of the year is as follows:

Assets:		Liabilities:	
Cash	2,000,000	Accounts Payable	1,000,000
Receivables	7,000,000		
Inventory	10,000,000	Equity:	
Office Furniture	50,000	Equity Investment	10,000
		Earnings	18,040,000

Under these facts there has not been a deemed dividend from the branch. Instead, the books and records merely indicate that the branch has collected 1,000,000 of its accounts receivable. All of that cash is still on the books of the branch, however. Any interest on that cash will be taxed in Afghanistan. Hence, there has not been a distribution.

Example 2. *Kashif is a resident of Pakistan that operates an import-export business within Afghanistan. Kashif has chosen to operate his import-export business as a branch, not a corporation. At the beginning of the year, the balance sheet for the branch is as follows:*

Assets:		Liabilities:	
Cash	1,000,000	Accounts Payable	1,000,000
Receivables	8,000,000		
Inventory	10,000,000	Equity:	
Office Furniture	50,000	Equity Investment	10,000
		Earnings	18,040,000

During the year, the corporation generates Afs. 1,000,000 earnings. The balance sheet for the branch at the end of the year is as follows:

Assets:		Liabilities:	
Cash	2,000,000	Accounts Payable	1,000,000
Receivables	8,000,000		
Inventory	10,000,000	Equity:	
Office Furniture	50,000	Equity Investment	10,000
		Earnings	19,040,000

Under these facts there has not been any constructive dividend distribution. Although the branch generated an additional Afs. 1,000,000 of earnings during the year, the earnings continued to be reflected on the branch's balance sheet. As such, any interest accrued on the additional Afs. 1,000,000 held by the branch will be subject to tax in Afghanistan.

Example 3. *Kashif is a resident of Pakistan that operates an import-export business within Afghanistan. Kashif has chosen to operate his import-export business as a branch, not a corporation. At the beginning of the year, the balance sheet for the branch is as follows:*

Assets:		Liabilities:	
Cash	1,000,000	Accounts Payable	1,000,000
Receivables	8,000,000		
Inventory	10,000,000	Equity:	
Office Furniture	50,000	Equity Investment	10,000
		Earnings	18,040,000

During the year, the corporation generates Afs. 1,000,000 earnings. The balance sheet for the branch at the end of the year is as follows:

Assets:		Liabilities:	
Cash	2,000,000	Accounts Payable	1,000,000
Receivables	7,000,000		
Inventory	10,000,000	Equity:	
Office Furniture	50,000	Equity Investment	10,000
		Earnings	18,040,000

Under these facts there has been a constructive dividend distribution of Afs. 1,000,000. The branch generated an additional Afs. 1,000,000 of earnings during the year. The earnings were reflected in a Afs. 1,000,000 increase in the branch's cash balance. But the receivables decreased by a like amount. In the end, no amount was added to the branch's equity. Because Afs. 1,000,000 was earned by the branch, but the extra Afs. 1,000,000 were not reflected in the branch's equity, the branch is deemed to have distributed Afs. 1,000,000 to Kashif. As such, the dividend is subject to 20 percent income tax.

Remark: Because the purpose of the tax on the deemed dividends of a branch is to equalize the tax treatment of Afghan branches and corporations, the deemed dividends paid by the branch shall be deductible by the branch in computing the branch's taxable income.

- 13.9 The tax on the deemed dividends of a branch shall apply equally to non-residents that invest in Afghanistan through a partnership. It does not matter whether the partnership is domestic or foreign.

Example. USCO is a United States corporation. CANCO is a Canadian corporation. USCO and CANCO are partners in an Afghan partnership. USCO owns 60% of the partnership and CANCO owns 40% of the partnership. The opening balance sheet for the partnership at the beginning of the year is as follows:

Assets:		Liabilities:	
Cash	1,000,000	Accounts Payable	1,000,000
Receivables	8,000,000		
Inventory	10,000,000	Equity:	
Office Furniture	50,000	Capital	10,000
		Earnings	18,040,000

During the year, the corporation generates Afs. 1,000,000 earnings. The balance sheet for the branch at the end of the year is as follows:

Assets:		Liabilities:	
Cash	2,000,000	Accounts Payable	1,000,000
Receivables	7,000,000		
Inventory	10,000,000	Equity:	
Office Furniture	50,000	Capital	10,000
		Earnings	18,040,000

The additional 1,000,000 Afghanis of profit should have caused the partnership's earnings to increase by 1,000,000. Because the earnings did not increase by 1,000,000 Afghanis, there has been a constructive distribution of 1,000,000 Afghanis under these facts. There is a presumption that USCO received 600,000 of the distribution and CANCO received 400,000 of the distribution. The parties may rebut this presumption if they can prove that the distribution was shared in a different ratio.

13.10 "Receipts" in the case of taxpayers who account on an accrual basis (See Chapter V of the Income Tax Law), also means accrued sales, accrued interest income, accrued rental income, etc.

Example: *A limited liability company has cash sales in 1384 of Afs. 8,700,000. If Afs. 300,000 of the sales which were made in the last month of 1384, were not paid until the first month of the following year, 1385, the sales of Afs. 300,000 are included and accrued to the sales for 1384. Under the accrual system of accounting, sales are considered to be income at the time the sale is made rather than when the payment is received; therefore, the income for the taxable year for this company, which is required to use the accrual system, is Afs. 9,000,000 (the amount of sales) rather than Afs. 8,700,000 (the amount of payments actually received).*

Non-Taxable Income

Article 14. The following receipts are not subject to income tax and not included in returns of natural and legal persons:

1. grants, gifts, and awards of the State;
2. grants, gifts, and awards of foreign governments, international organizations, or nonprofit organizations for contributions to science, art, literature, social progress, and international understanding;
3. all scholarships, fellowships, and grants for professional and technical training;
4. health, accident, and unemployment insurance benefits;
5. life insurance paid on death;
6. compensation or damages for personal injuries or sickness or restitution of reputation;
7. proceeds of borrowing;
8. proceeds of issues of stocks and bonds by companies;
9. acquisition of property in connection with mergers of domestic corporations and other legal entities;
10. acquisition of movable or immovable property through expropriation of property of debtors by creditors
11. payments on principal received from debtors;
12. interest on deposits of individuals from State banks;
13. interest on bonds issued by the State and by municipalities; and
14. any other receipts according to the provisions of this Law.

14.1 Article 14 of the Income Tax Law covers receipts which are excluded from gross income. Receipts, unless specifically listed as excluded from income, are included in income.

14.2 "Grants, gifts, and awards of State" do not include payments made to employees for services performed in the ordinary course of duty. Grants, gifts, and awards are given in special circumstances or in recognition of issued or unusual service or accomplishment. They are associated with hardship, or recognition of accomplishment. Annual bonuses, overtime, back pay and other benefits given on a nonselective basis are part of the taxable income of the recipient.

Example 1: A family is struck by a calamity. This family receives Afs. 5,000 as a

gift from the State. This Afs. 5,000 is not taxable income of any of the members of the family.

Remark: *Amounts donated or granted by foreign and/or domestic institutions are also not taxable.*

Example 2: *A medical doctor devotes his life to building up medical clinics, facilities, and staff in several communities. The State honors him with an intangible recognition, and also with tangible material award. Such material gain is exempt from taxation.*

Example 3: *The receipt of a Nobel prize is an award of an international, nonprofit organization that is exempt from taxation.*

- 14.3 All of the money received in connection with a scholarship, fellowship, or grant for professional and technical training is exempt. This includes travel funds and living expense funds, as well as reimbursement for tuition, fees, cost of books and supplies, and other expenses.

Example: *A student receives a scholarship which covers his travel, hotel bills, lodging, tuition, fees, books, medical costs, etc., plus an allowance for clothing, food, and personal expenses of Afs. 5,000 per month. All of this is exempt from taxation.*

If the student receives a supplement from the State, this supplement is also exempt from taxation. If, however, as an employee of the State, he receives all or part of his salary from the State, this salary is subject to taxation.

- 14.4 Payment received from an insurance company as a result of loss, misfortune, sickness, etc. against which the recipient was insured is not taxable.

Example 1: *An individual insured himself against sickness and injury with an insurance company to which he paid monthly premiums. He was injured in an accident which resulted in lost income and medical expenses, and caused a disability. Under terms of his insurance policy he was paid Afs. 10,000,000 in settlement of his claim. This receipt is not taxable.*

Example 2: *An individual is injured while working at his job. His employer carries an insurance policy which covers all his employees. The insurance company pays the injured employee Afs. 10,000,000 in settlement of his claim. This receipt is exempt from taxation, though the injured employee did not even pay the premium for the insurance coverage.*

- 14.5 Payment received by a beneficiary from insurance upon the death of the insured person is not taxable income of the beneficiary.

Example 1: *An individual has purchased an insurance policy which provides, among other things, that his beneficiary shall be paid Afs. 2,000 per month upon death of the insured. This income is not taxable.*

Remark: *Regardless of whom the beneficiary is or how the insurance benefit is paid, the money paid by the*

insurance company is not subject to income tax.

Example 2: *An individual is killed in an accident while working on his job. His employer carries an insurance policy which covers all of his employees. The insurance company pays the amount of the death benefit specified by the policy to the beneficiary of the deceased. This receipt is exempt from taxation even though the deceased did not pay the premium for the insurance coverage.*

- 14.6 Compensation paid for personal injuries, sickness, or other harm inflicted on a person is not taxable.

Example 1: *A person struck and injured by an automobile receives Afs. 10,000 as compensation for the harm done. This receipt is not taxable.*

Example 2: *A person develops a disabling disease from his employment by a firm in an occupation exposing him to harmful chemicals. Upon order of a court, the firm pays the disabled person Afs. 2,000 per month for the period of his disability. This income is not taxable.*

- 14.7 Receipts which are proceeds of borrowing are not taxable.

Example: *An individual receives Afs. 25,000 from a bank in exchange for his promissory note. This receipt is not income and is not taxable.*

- 14.8 Receipts from the issue of stock or sale of bonds by a corporation is not taxable income.

Example 1: *A corporation increases its capital by issuing shares of stock at a par value of Afs. 1,000 per share. The corporation sells 10,000 shares at Afs. 1,000 each. The Afs. 10,000,000 received is not taxable.*

Example 2: *A corporation sells bonds redeemable in 10 years at Afs. 5,000 each with interest payable annually at a rate of five per cent. It sells 1,000 such bonds, receiving Afs. 5,000 for each bond. The proceeds, Afs. 5,000,000 are not taxable.*

Remark: *If, however, these bonds bring more than face value, the excess is subject to income tax. On the other hand, if bonds are sold for less than redeemable value, the discount in value is a deductible expense. The excess, called a premium, is in fact a reduction in interest over the term of the bond, while the discount is in fact additional interest over the term of the bond. Either shall be allocated over the term (period of years from date of issue to date of redemption) of the bond.*

- 14.9 Assets acquired through mergers are not taxable at the corporate or shareholder level if one of the following requirements are satisfied:

- (a) The transaction qualifies as a "merger" under Afghanistan's 1955 Commercial Code or any successor law to the extent that the

shareholders exchange stock of the merged corporations for stock of the surviving corporation.

Example 1: Corporation A merges with Corporation B to form a new corporation. In the process of this merger the new corporation acquires the cash, and other assets as well as the liabilities of Corporations A and B. The shareholders of Corporation A and B surrender their shares in exchange for shares in the new corporation. Neither Corporation A nor Corporation B recognizes income in this transaction. Because the shareholders of Corporation A and Corporation B exchange their shares for shares of the surviving corporation, they do not have to recognize income.

Example 2: Naqibullah owns all of the issued stock of Corporation A. Naqibullah has an Afs. 10,000 cost basis in his shares. Naqibullah's shares are worth Afs. 500,000. Wahid owns all of the issued stock of Corporation B. Wahid has an Afs. 20,000 cost basis in his shares. Wahid's shares are also worth Afs. 500,000. Naqibullah and Wahid decide that they should merge their two corporations. In the merger, Naqibullah receives 50 shares of the surviving corporation. Wahid receives 45 shares of the surviving corporation and Afs. 50,000. To the extent that Naqibullah receives shares in the merger, the transaction is tax-free to Naqibullah. Naqibullah therefore takes the 50 shares with a carryover basis of Afs. 10,000. Wahid's consideration consists of shares (90%) and cash (10%). The shares can be received tax-free. Wahid takes the shares with a carryover basis of Afs. 18,000. Wahid's receipt of cash is taxable. Wahid must recognize gain of Afs. 30,000 (Afs. 50,000 – Afs. 20,000 cost basis in 10% of shares). Neither Corporation A nor Corporation B recognizes gain or loss on the transaction.

- (b) An Afghan resident may transfer stock or other property to an Afghan corporation or limited liability company provided that, after the exchange, the Afghan resident owns 5% or more of the stock of the transferee. For this purpose, stock shall be measured by both voting power and value.

Example 1: Naqibullah and Wahid are Afghan residents that want to form a corporation which will operate a clothing store in Kabul City. Naqibullah contributes Afs. 500,000 to the corporation in exchange for 50% of its shares. Wahid contributes clothing inventory that he has acquired to the corporation in exchange for 50% of its shares. Wahid had a cost basis of 200,000 Afghanis in the clothes that he contributed. Naqibullah cannot recognize gain or loss on the transfer of Afghan currency to the corporation. Because Wahid received shares representing more than 5% of the corporation, the transfer is considered tax-free. Wahid receives the shares of the corporation with a Afs. 200,000 cost basis. The corporation takes the clothing with a Afs. 200,000 cost basis.

Example 2: Naqibullah and Wahid are Afghan residents that together own all of the stock of an Afghan limited liability company. Naqibullah's cousin, Adib, has some useful equipment which he would like to contribute to the business in exchange for stock ownership in the

business. Adib has a cost basis of Afs. 100,000 in the equipment. Naqibullah and Wahid agree to cause their corporation to issue stock to Adib in exchange for the equipment. The stock issued to Adib represents 7% of the value of the entire corporation, but does not possess any voting rights. The stock is worth approximately Afs. 175,000. Because Adib does not hold any voting rights in the corporation after the transfer, the transfer is not tax-free to Adib. Adib must therefore recognize gain of Afs. 75,000. The corporation takes the equipment with a fair market value cost basis of Afs. 175,000.

Example 3: *Naqibullah and Wahid are Afghan residents that together own all of the stock of an Afghan limited liability company. Naqibullah and Wahid decide that Naqibullah should transfer some appreciated land to the limited liability company. The two shareholders agree that Naqibullah should be entitled to receive an additional 2% interest in the voting power and value of the corporation in exchange for the contributed land. Thus, Naqibullah transfers the land to the limited liability company. After the transfer, Naqibullah owns 52% of the entity and Wahid owns 48% of the entity. Even though Naqibullah did not receive a 5% or greater interest in the limited liability company (measured by vote and value) in exchange for the transferred land, the transfer is considered tax-free because Naqibullah owns 5% or more of the voting power and value of the entity immediately after the transfer.*

- 14.10 Money received by the lender from the borrower in repayment of a loan is not income and is therefore not subject to income tax.
- 14.11 Interest received by individuals on their deposits in banks in Afghanistan is exempt from taxation.

Example: *A person deposits Afs. 100,000 in one of the banks operating in Afghanistan and receives Afs. 3,000 every six months as interest on this deposit. This person is not required to pay any tax on such interest income.*

Remark: *The nationality of the bank is not relevant. All that is relevant is that the bank have operations within Afghanistan and takes deposits from Afghan residents. Thus, if an Afghan resident deposits money with a bank that is based in Turkey, but has a branch within Afghanistan, the interest income the Afghan resident earns on the account will be exempt from tax.*

- 14.12 Interest received by limited liability companies and corporations on deposits in banks in Afghanistan is subject to taxation.

Example: *A limited liability company deposits Afs. 500,000 in a bank in Kabul and receives Afs. 15,000 every year as interest on this deposit. This receipt is subject to taxation and must be reported as income by the company.*

- 14.13 Interest received by partnerships is deemed to be received by the partners of the partnership for purposes of applying the rules in Article 14(12).

- 14.14 Interest on bonds issued by the State or by municipalities of Afghanistan is exempt, whether received by an individual (Afghan or alien), a corporation, or a limited liability company, (Afghan or foreign).

Example: A limited liability company buys government bonds totaling Afs. 500,000. Every year the Treasury Department of the Ministry of Finance makes an interest payment to the company. Since this receipt is an interest on government bonds, it is not subject to the income tax, and is not reported by the company its income tax return.

- 14.15 The value of property acquired by gift, bequest, devise, or inheritance is excluded from income, but the income from such property is includable in gross income.

Food and Fuel Tax Exemption

Article 15. Income represented by the value of food, fuel, and goods consumed or used by the producer of the same or by members of his household is excluded from income tax.

15.1 The “producer” is the person who made the item or article used by himself or his dependants.

Example: *An artisan owns a small carpentry shop where he makes furniture. During the year he makes a table and six chairs which he uses in his own home. He does not have to include the value of these items on this return.*

Remark: *In most cases, the producer will pay the fixed tax under Chapter XI of the Income Tax Law, which is in lieu of income taxes. In applying the provisions of Chapter XI, the amount of goods normally consumed by the taxpayer and his dependants is taken into account in arriving at the net income potential of his establishment.*

Taxes on Rent and Lease of Immovable Properties

Article 16 Rent received in money or otherwise from renting and leasing immovable property used for commercial, industrial and other economic purposes is subject to income tax. Taxation of agricultural lands, gardens, and livestock together with their income are taxed by separate laws.

16.1 Taxation of the yield from agriculture and animal husbandry is not subject to the Income Tax Law. The income of the farmer, the landowner, the herdsman, or owner of livestock derived from agricultural or livestock production is not subject to income taxes.

a. The following examples are types of income excluded from income taxes by Article 16 of the Income Tax Law:

1. money received from the sale of grain by the person who produced the grain or by the person on whose land it was grown;
2. rent in money received by the landowner for land devoted to production of crops, fruit, timber, or used for pasture and grazing of animals;
3. money received from the sale of wool, skins, dairy products, meat, live animals, and other products of animal husbandry by the owner of the animals or by the person caring for the animals; and
4. money received by the owner of herds of livestock as his share of the income from such herds.

b. The following examples are types of income not excluded from taxation under the Income Tax Law:

1. income from industrial and commercial processing of agricultural or animal products;
2. income from trade in agricultural or animal products;
3. income from rental of land not devoted to agricultural production; and
4. income from sale of supplies, fertilizer, equipment, chemicals, etc. to landowners, farmers, and herdsman, even if used in agricultural and livestock production.

Example 1: *Naqibullah owns and operates a farm on which he produces wheat. Naqibullah sells the wheat to Azziz who is in the business of purchasing wheat from farmers and reselling it to flour mills. Azziz sells the wheat that he purchased from Naqibullah to a flour mill in Kabul that is owned by Wahid. The flour mill grinds the wheat into flour and sells the flour to merchants in Kabul. Naqibullah is not subject to income tax. Azziz, Wahid, and the merchants that sell the flour are all*

subject to the Income Tax Law.

Example 2: *Adib owns a farm. Adib uses a tractor on his farm. He also rents the tractor to other farmers when he is not using it. The rental income that Adib receives will be subject to income tax, even if Adib rents the tractor to other farmers.*

- 16.2 The owners of tangible property, primarily used for commercial, industrial, or other economic purposes, are subject to income tax on income received from renting and leasing such property.

Example 1: *The owners of commercial shops and sarais are subject to income tax on income received from the renting or leasing of such property.*

Example 2: *The owners of factories and compounds used for industrial purposes are subject to income tax on income received from renting and leasing such property.*

Example 3: *Adib owns a farm and uses a tractor on that farm. When he is not using the tractor for farming, Adib rents the tractor to contractors in the nearest city who use the tractor to haul bricks and mortar. The income that Adib earns from renting the tractor is included in taxable income, even though the tractor is used during a portion of the year in his farming operations.*

Liability to Withholding Tax from Salary or Wages

- Article 17 (1) Ministries, agencies and other government organizations, enterprises, companies and charitable institutions are required to withhold taxes from the salary or wages of its employees when they are being paid and transfer the withheld amount to the government account.
- (2) Pensions of government employees are exempt from income tax.

17.1 The process and procedure for complying with the wage withholding tax provisions are set forth in Ministry of Finance publications Guide 5 'Wage Withholding Tax' and Public Ruling titled 'Salary or Wages in Afghanistan'. Both publications are available at the Ministry of Finance's website at www.mof.gov.af/tax.

17.2 Only payments to "employees" are subject to withholding. Payments made to natural persons who are "independent contractors" are not subject to withholding. Instead, the independent contractor is responsible for paying annual income tax.

17.3 The following factors shall be considered in determining whether a person is an "employee" or an "independent contractor" under this Article 17 and Article 46. For this purpose, the "principal" shall be the person for whom services are performed and the "service provider" is the person that is performing the services for consideration.

(a) The degree of control that the principal has over the manner in which the service provider performs the services. In this regard, due consideration will be given to whether the principal controls the hours that the service provider must perform and the manner in which the work is done.

Remark: The foregoing factor will typically be the most significant factor in making the determination as to whether someone is an employee or an independent contractor.

(b) The degree to which the principal provides the service provider with the tools that the service provider uses to perform his or her services.

(c) Whether the principal engages a specific individual to perform services.

(d) The manner of payment (e.g., pay by the hour vs. payment upon completion).

(e) Whether payment is fixed or contingent upon the occurrence of events.

(f) The typical arrangement in the marketplace – i.e., are the providers of this particular type of service usually treated as employees or independent contractors?

- (g) The manner in which the service providers are treated by the principal. Due consideration will be given to whether the service providers are referred to as “employees” by the principal.

Example 1: *The Ministry of Communications pays 5 individuals to fix transmission towers. The individuals earn a fixed amount of Afs. 20,500 per month. The Ministry instructs the individuals when the towers are to be fixed. The Ministry provides very detailed rules that have to be followed in terms of safety. The Ministry provides the individuals with trucks and tools. The individuals do not have to purchase their own equipment, but they do purchase their own uniforms for the job. Under these facts, the Ministry will be considered the “employer” and the 5 individuals will be considered “employees”. The Ministry will have to withhold Afs. 800 per month ($\text{Afs. } 20,500 - 12,500 = 8,000 \times 10\%$).*

Deductible Expenses

Article 18. (1) Deduction of all ordinary and necessary expenses of the production, collection, and preservation of income of natural and legal persons is allowed and deductible as follows, provided that these expenses have been incurred during the taxable year, or one of the three previous years, in accordance with the provisions of this Law.

1. Any expense related to the cost of production or trade and business, such as insurance and freight expenses, etc.;
2. The cost of supplies, materials, fuel, electricity, water, and ordinary and necessary expenses used in the production of income, or in a trade or business;
3. Wages, salaries, commissions, and fees paid for services rendered by employees in trade or business;
4. Interest paid on business loans;
5. Rent paid on property necessary to and used in trade or business;
6. Cost of repairs and maintenance of properties and equipment necessary to and used for purposes of the business or trade;
7. Depreciation of movable and immovable property (except agricultural land) used in a trade or business or held by the producer for the production of income in accordance with the Income Tax Manual. The total of deductions for depreciation of any item of property over a period of years shall not exceed its cost to the taxpayer;
8. Any tax or charge that is necessary expense of doing business, holding property for income, or of producing income, if paid or accrued during the taxable year. Taxes imposed by this Law and taxes not qualifying as necessary business expense are not deductible, except as otherwise provided by this Law;
9. Damages to movable or immovable property caused by fire, earthquake, and by casualty or disaster of any kind, over a three year period, to the extent that the cost is determined and substantiated by records and the loss was not recovered by insurance;
10. Losses in business or trade from bad debts according to the Income Tax Manual;
11. Dividends paid in money by a legal entity organized under the laws of Afghanistan; and
12. Other expenses of doing business and of holding movable or immovable property for the production of income under relevant

laws.

(2) No deductions are allowed for the following expenses:

1. Expenses incurred to provide entertainment or advertising that are not connected to economic or commercial activities;
2. Dividends, interest, royalties, rents, commissions, wages, salaries and similar expenses from which legal persons are required under provisions of this Law to withhold tax but have failed to do so; and
3. In the case of a branch in Afghanistan of a non-resident person, any expenses paid or incurred to the non-resident person or any person connected to the non-resident person.

18.1 Expenses and costs ordinarily incurred in the production of income are deducted from profit or net income from that activity to determine the amount of taxable income. Article 18 of the Income Tax Law lists the ordinary and necessary costs and expenses that are deductible from receipts in determination of taxable income of any business activity of an individual, of a limited liability company, or of a corporation. Expenses and costs may be incurred which are not deductible for purposes of income taxation. Thus, the profit or net income of a business may be different according to the records of the owner than net income determined in accordance with the Law. Expenditures which are not ordinary and necessary expenses are not deductible.

Examples of non-deductible expenditures are:

- a. gifts;
- b. illegal expenditures;
- c. donations;
- d. income taxes;
- e. additions to reserves that are not required by law or that cannot be justified from experience (See Article 19(2)2 of the Income Tax Law);
- f. any excessive amount added to a reserve required by law, or justifiable from experience (See Article 19(2)2 and Article 56 of the Income Tax Law);
- g. cost of goods purchased but used by the owners or employees for personal or household purposes and not sold;
- h. cost of goods purchased but subsequently returned to supplier or manufacturer; and

- i. cost and expense of providing benefits for the owners, officers, and management that are not necessary for the conduct of business.

Example 1: An individual owns a factory. Out of the income from the factory, the factory purchases an automobile for the individual's family. Such expenditures are not deductible in determining the taxable income of the individual.

Example 2: An automobile dealer purchases 10 automobiles for resale at a cost of Afs. 160,000 each. He keeps two of these for his family's use and sells eight at an average price of Afs. 200,000. If all purchases were allowed as a deduction, profit would be understated:

a. Sales receipt (8 x Afs. 200,000)	Afs. 1,600,000
b. Cost of purchase (10 x Afs. 160,000)	<u>1,600,000</u>
c. Gross profit	none

Whereas the correct statement would be:

a. Sales receipt (8 x Afs. 200,000)	Afs. 1,600,000
b. Cost of purchase – less 2 automobiles for personal use (8 x Afs. 160,000)	<u>1,280,000</u>
c. Gross profit	Afs. 320,000

- 18.2 Interest paid on business debts is deductible, but interest paid on personal debts is not. A personal debt is one incurred for purchase of goods and services or property for personal consumption and use. A business debt is one incurred in purchase of land, buildings, equipment, goods, etc., for leasing, resale, production of goods and services, and other business purposes.

Example: Azziz borrows money from his brother, Wahid, to purchase a computer. Wahid charges Azziz 2% interest per year. Azziz cannot deduct the interest that Azziz pays to Wahid.

- 18.3 Depreciation and recovery of cost basis shall not be allowed unless the taxpayer has clearly established the cost of the property being depreciated or recovered. Any cost established for purposes of claiming depreciation expense is binding on the taxpayer for purposes of determining gain from sale of the same property.

Example 1: Adib purchased a motorcycle for use in his business 3 years ago. Adib never kept the receipt from the purchase. Adib now sells the motorcycle for Afs. 30,000. Adib does not present any evidence about what the cost of the motorcycle was to him. Adib must recognize gain of Afs. 30,000.

Example 2: Adib purchased a motorcycle for use in his business 3 years ago. Adib never kept the receipt from the purchase. Adib now sells the motorcycle for Afs. 30,000. Adib is able to demonstrate that motorcycles of this type normally cost Afs. 50,000. The man who sold him the motorcycle confirms this. Adib will be permitted to deduct Afs. 20,000.

- 18.4 If an owner of a building is not able to clearly establish his cost basis and depreciation, the Ministry of Finance may not allow any deductions. If the owner provides acceptable documents regarding his cost basis and depreciation, then in this case, the deduction for depreciation will be allowed.
- 18.5 In certain cases it will be unclear whether a transaction involves the loan of money secured by an interest in property or whether it involves the lease of property. In making this determination, the Ministry of Finance shall consider a number of relevant facts and circumstances. In making this determination, the primary factor shall be the ownership of legal title to the underlying property. If a transaction results in the legal owner of an item of property receiving payment for the use of that property, the transaction will be presumed to be a "lease". If a transaction results in the transfer of legal ownership of underlying property in exchange for payment, the transaction will be presumed to be a "sale". Nevertheless, if the lease term exceeds twelve (12) months and one or more of the following factors exist, the presumption will be overcome and the transaction will be considered a "financing lease". The lessor in a financing lease shall be considered to have sold the property to the lessee. The lessee will be considered to have purchased the property in exchange for its obligation to repay the purchase price to the lessor. The lessee in this case will be entitled to depreciate the property and the lessee will have to separate each lease payment into its principal component (which is not deductible) and its interest component (which is deductible). The aforementioned factors are as follows:
- (a) the lessee has an option to assume ownership of the underlying property at the end of the lease term;
 - (b) the lease term exceeds 80% of the useful life of the underlying asset;
 - (c) the lessee shall have the right to purchase the property at the end of the lease term at a price that is lower than the expected fair market value of the property measured on the date that the lease is entered into;
 - (d) the residual value of the underlying property at the end of the lease term is expected to be less than 20% of the value of the property at the beginning of the lease term; or
 - (e) the present value of the expected lease payments, measured using a reasonable discount rate, exceeds 90% of the value of the underlying property measured on the date the lease is entered into.

Example: Wahid "leases" equipment to Azziz. Wahid retains legal title to the equipment during the lease term. The equipment has a useful life of 5 years. The lease term is for a period of 4.5 years. The lease provides that Azziz has the right to purchase the property at the end of the lease term for 1 Afghani. The parties believe, at the time they enter into the lease, that

the value of the property will be in excess of 1 Afghani. Even though this transaction is labeled a "lease," the Ministry of Finance is entitled to treat this transaction as if Wahid sold the equipment to Azziz in exchange for a debt instrument issued by Azziz to Wahid. This debt instrument shall be deemed to bear a reasonable rate of interest considering all of the facts and circumstances. The lease payments will be treated as payments of principal and interest and the interest component will be allowed as a deduction to Aziz. Aziz will also be entitled to claim depreciation on the equipment.

Wahid will treat the 'lease' of the equipment as a sale. The interest component of the 'lease' payment will be assessable income to Wahid.

18.6 When the cost of depreciable business assets is determined from documentary evidence, the depreciation expense that may be deducted each year is subject to the following provisions:

- a. All institutions and agencies are required to observe the following percentages and standards with respect to the depreciation of their buildings, machinery, and other supplies.
- b. The percentage shall be based on the cost.
- c. The percentages and standards shall be established by the Ministry of Finance in consultation with the Ministry of Mines and Industries at appropriate times and brought to the attention of institutions and agencies.
- d. Depreciation is an annual allowance. If a taxpayer fails to deduct or deducts an understated amount for one taxable year, he may not deduct the depreciation omitted or the amount understated in another year.

No.	Kind of asset	Period of Useful Life (in years)	Percentage Allowed Each Year
1.	Brick or stone structures	50	2
2.	Loam structures	20	5
3.	Wooden structure	10	10
4.	Machinery and equipment not otherwise specified below	10	10
5.	Mining equipment	6.5	15
6.	Tools	4	25
7.	Printing equipment and machines	2	50
8.	Handicraft machines	3	33
9.	Metallurgical machines	10	10
10.	Carpets	10	10
11.	Rugs and other furnishings	4	25
12.	Chairs, seats, and sofas	4	25
13.	Desks, tables, and cabinets	10	10
14.	Office equipment (calculators, typewriters, telephones, etc.)	6.5	15
15.	Bicycles	5	20
16.	Trucks	2	50
17.	Cars	4	25
18.	Tires and tubes	2	50

19.	Sacks	2	50
20.	Impure iron stoves and pipes	10	10
21.	Iron stoves	2	50
22.	Carriages, animal carts, and handcarts	3	33
23.	Construction machines, rollers, and mixers	5	20
24.	Computers and computer related equipment	3	33
25.	Televisions, radios, cellular phones	3	33
26.	Telecommunications equipment / cell towers	7	14

- 18.7 “Wages” and “salaries” include such items as regular pay, bonuses, over time pay, retroactive increases, and other valuable considerations paid by the employer in money or other forms.

Example: *An employee works for a company for a monthly salary of Afs. 20,000. In Caus, he receives a promotion and his salary is increased to Afs. 24,000, effective as of Meezon 1. At the end of the year, the company pays each employee a bonus of five per cent of his salary. In reporting the salary paid to the employee, the company must include all of these items, and the employee must report them on his income tax return as follows:*

a.	Salary (first 6 months) (6 x Afs. 20,000)	Afs. 120,000
b.	Salary (second 6 months) (6 x Afs. 24,000)	<u>144,000</u>
c.	Total 12 months' salary	Afs. 264,000
d.	Five per cent of yearly salary at the end of the year (5% of Afs. 264,000)	<u>13,200</u>
e.	Total income from the company	Afs. 277,200

- 18.8 Payment by the employer of the personal income tax of his employee is payment of additional salary or wages to the employee and as such is subject to taxation.

- 18.9 The municipal tax on leased property is deductible from rental income.

Example: *A tax of Afs. 20,000 is paid to a municipality on commercial property leased to a tenant for Afs. 240,000 per year. This tax is deductible from rental income. If depreciation was Afs 20,000 and repairs were Afs 4,000 and no other deductible expenses were incurred, the net income from this property would be:*

a.	Gross rent	Afs. 240,000
b.	Municipal tax	Afs. 20,000
	Depreciation and repairs (see Regulation 18.4)	<u>24,000</u>
c.	Net income	- <u>44,000</u> 196,000

- 18.10 Net income taxes are not deductible in computing net income.

Example: *A corporation has a net income in the taxable year of Afs. 800,000. During the taxable year it paid income taxes of Afs. 120,000 on income received during the previous year. This amount is not deductible nor is the income tax for the current year deductible.*

- 18.11 An employer can deduct certain non-cash benefits that it provides to its employees, provided that the provision of the benefits is directly related to the employer's business.

Example: *A construction company which is building a dam some distance from any town finds that it must provide transportation between the nearest town and the construction site each day to induce laborers to work at the project site. This is a legitimate expense of doing business and the company may deduct the cost of providing such transportation.*

Remark: *If some of the employees drive their own cars to the project site, they cannot deduct the cost of traveling to and from work from their income when filing their individual income tax returns.*

- 18.12 Loss of property used for production, collection, or preservation of income caused by fire, wind, earthquake, casualty, or disaster of any kind may be deducted to the extent that such loss was not reimbursed by insurance. To claim such a deduction, the owner must have kept records which clearly show the value or cost of the property lost. One third of the loss may be claimed in the current year and each of the succeeding two years.

- 18.13 Premiums paid for insurance of property used for the production, collection, and preservation of income are a legitimate cost of doing business and are fully deductible. Receipts from an insurance company as the result of a loss are not taxable unless the amount of reimbursement exceeds the cost or depreciated value of the property lost. If the amount of reimbursement received exceeds the depreciated value of the property, the excess must be reported as income by the owner.

Example. *An individual operates a car dealership in Kabul. Due to a severe storm, two of the cars on the individual's lot are damaged. One car is a Toyota. The other car is a Mercedes. All of the cars are fully insured. The individual purchased the Mercedes for Afs. 1,000,000. The individual purchased the Toyota for Afs. 800,000. After filing an insurance claim for the damage, the individual receives Afs. 700,000 for the Mercedes and Afs. 850,000 for the Toyota. The individual is entitled to recognize a loss of Afs. 300,000 with respect to the Mercedes, but must recognize income of Afs. 50,000 with respect to the Toyota. The loss of Afs. 300,000 may be claimed over the course of three years. The first Afs. 100,000 loss may be claimed in the current year. An addition Afs. 100,000 may be deducted in each of the subsequent two years.*

- 18.14 A taxpayer will be allowed a deduction in a tax year for a bad debt if the following conditions are satisfied:

- (a) the amount of the debt was previously included in the taxable income of the taxpayer;
- (b) the debt is written off in the accounts of the taxpayer during the tax year; and

- (c) the taxpayer has reasonable grounds for believing that the debt will not be recovered.

This requirement will not apply to a bank entitled to a deduction for additions to reserves against losses in accordance with Article 56 of this Law.

Example: *Ahmad Advertising Company provides advertising services for newspapers and radio. Ahmad Advertising Company has an arrangement with Shiraz Restaurant where Ahmad Advertising Company places advertisements each month in the newspaper and the radio and then sends an invoice for Afs 5,000 to Shiraz Restaurant for payment. One month, Shiraz does not make the payment. Ahmad Advertising Company cancels the arrangement. Ahmad Advertising Company, being required to account on the accruals basis and having provided the advertising services, has already included the amount of Afs 5,000 in its income. Ahmad Advertising Company makes attempts to collect the money. It makes phone calls and sends a letter to Shiraz Restaurant but no payment is received. Eventually, Shiraz Restaurant closes its business.*

Ahmad Advertising Company has reasonable grounds for believing that the debt will not be recovered. It may treat the amount as a bad debt and claim an income tax deduction for the amount not received.

Remark: *If an amount is written off as a bad debt, but the debtor subsequently pays some or all of the amount written off, then this amount will be treated as income.*

Non-Deductible Expenses

Article 19. (1) Personal expenses including the following expenses are not deductible:

1. payments paid to persons for his or his family's benefit and enjoyment;
2. expenses and costs of maintenance, repair, construction, improvement, furnishing, and other expenses of the taxpayer's or his family's house or residence or any property devoted to his own personal or family's use;
3. interest on personal loans;
4. costs of commuting to and from work and cost of travel for personal purposes;
5. cost of life, accident, health, and liability insurance for the protection of the taxpayer and his family; and
6. cost of insurance of any kind for the protection of property used for personal purposes.

(2) The following expenses are not deductible:

1. The cost of acquiring land, buildings, durable items such as machinery, equipment, fixtures, and furniture, or costs of additions or improvements to the same. Depreciation expense allowable under sub-paragraph 1(7) of Article 18 and the provisions of Chapter 3 of this Law are excepted from this paragraph;
2. Additions to reserves for contingencies, bad debts, and other similar purposes; and
3. Taxes paid to foreign countries by non-resident persons on income from sources within Afghanistan, except as provided by an existing treaty.

19.1 The expenses listed under Article 19(1) of the Income Tax Law are typical living expenses of an individual and his family that are specifically listed as not deductible to remove any uncertainty that could otherwise arise. No personal expenses are deductible. Examples of personal expenses are:

- a. cost of food, supplies, clothing and shelter for taxpayer and his dependants;
- b. costs of entertainment, recreation, books, and education for taxpayer and dependants;
- c. medical and dental expenses of taxpayer and dependants;

- d. contributions, gifts, and support given to unfortunates;
- e. expenses of repair and maintenance of automobile used for personal and family purposes;
- f. personal income taxes paid;
- g. tax on a residence occupied by the owner, or taxes of any kind except those that are expenses of a business from which income is taxable;
- h. fines paid for violations of law by the taxpayer or members of his family;
- i. losses (except losses covered by Article 18(1)9 of the Income Tax Law) of property through misfortune, theft, carelessness, etc.; and
- j. other costs and expenses that are not costs of doing business, producing income, etc.

19.2 Land is a fixed asset that is not depreciable for purposes of taxation. Unless destroyed by flood, landslide, etc., the land does not lose utility and value. Therefore, the cost of acquiring land is not deductible either at the time the land is purchased or as it is used. The cost of land is deducted from the price or value realized only when the land is sold or transferred (except by inheritance).

Example 1: *A corporation purchases a large tract of land as a site for a new factory. The cost of the land is not deductible from income nor can depreciation expense be claimed on the investment in land. The purchase price paid remains unchanged on the financial statement of the corporation until the land is sold in whole or in part.*

Example 2: *A corporation purchases a tract of land with an office building situated on the tract. The price paid for the entire property is Afs. 30,000,000. A division of this sum must be made on the books of the corporation between the cost of land and cost of improvements (buildings etc.). The cost allocated to land cannot be depreciated, but the cost allocated to improvements can be deducted in annual depreciation expense over the period of expected useful life of the improvements.*

19.3 An addition to a reserve is part of income set aside but not expended. If an amount is added to an already established reserve or is set aside to provide a new reserve which may be deemed necessary by the management, it is deductible if required by law.

Example 1: *If the law requires a bank to maintain a reserve for losses on loans equal to 25 percent of loans issued and the reserve is less than that amount, any amount needed to bring the reserve up to 25 percent of loans outstanding, and not exceeding that, may be added to that reserve and deducted from income before taxes are calculated.*

Thus, if loans outstanding were Afs. 2,000,000,000 at the end of the year, and the reserve for losses on loans was Afs. 475,000,000, the maximum amount that can be added to this reserve, in addition to the Afs. 475,000,000, can be found as follows:

- | | | |
|----|--|------------------|
| a. | 25% of loans outstanding (25% of Afs. 2,000,000,000) | Afs. 500,000,000 |
| b. | the amount of the existing reserve | - 475,000,000 |
| c. | the amount by which the reserve is less than the legal reserve | Afs. 25,000,000 |

So, this reserve is thus Afs. 25,000,000 less than the amount required by law. Therefore, an amount up to Afs. 25,000,000 may be set aside and deducted from income before taxes are assessed. If net income were Afs. 25,000,000 or less, the entire income could be set aside, leaving no income subject to income tax.

Remark: *The business receipts tax would not be affected by reserve additions.*

Example 2: *If the bank had reserve of Afs. 500,000,000 and outstanding loans of Afs. 2,000,000 at the end of the year, an addition to this reserve would not be deductible because the amount of the reserve already equaled 25 per cent of the amount of loans outstanding. Thus, if net income was Afs. 100,000,000, and Afs. 25,000,000 of this was added to the reserve for losses on loans, increasing the reserve to Afs. 525,000,000, the taxable income (Afs. 100,000,000) would not be reduced. The amount added to the reserve cannot be deducted from income, because the reserve was already at the amount required by law ($.25 \times \text{Afs. } 2,000,000,000 = \text{Afs. } 500,000,000$).*

Example 3: *Reserves for depreciation are not affected by Article 19 of the Income Tax Law. Allowable depreciation expenses may be deducted from the cost of the assets depreciated. (See Regulation 18.6 for allowable depreciation rates.)*

- 19.4 An expense that is not deductible may not be paid from a reserve built up out of tax-free income.

Example: *Since income taxes are not deductible from taxable income, charging income tax payments against tax-free reserves is essentially the same as deducting those taxes from income. If, on the other hand, the reserve for contingencies is not required by law and the reserve had been built up from income after taxes, the payment of income taxes may be charged against the reserve.*

- 19.5 Tax payments by aliens to foreign countries do not affect the taxes due to the State on income from sources in Afghanistan.

Example: *An alien may be subject to income taxes imposed by his own country on his income from sources in Afghanistan. The income from sources within Afghanistan is taxable by the Government of Afghanistan.*

Afghanistan has priority over taxation of such income and does not allow the taxes paid by the alien to his own country to affect (reduce) the tax due to the State. Therefore, such foreign tax paid cannot be deducted from taxable income or credited in computing the tax due under the Law. Thus, if an alien earns Afs. 500,000 from services performed by him in Afghanistan and in his country, regardless of how the tax due in his own country is calculated, the tax due in Afghanistan is unaffected.

Income from Domestic Sources

Article 20. (1) Income from sources within Afghanistan is as follows:

1. Interest from loans, deposits, investments, etc.;
2. Dividends received from resident companies doing business in Afghanistan;
3. Salaries, wages, self-employment income, etc., for services performed;
4. Rentals and royalties from any property (movable and immovable);
5. Gain from sale of immovable and movable property;
6. Commissions on sales of any kind including insurance;
7. Income from commercial activities within Afghanistan;
8. Gains from the sale or transfer of any movable property used in commercial or employment activities;
9. Royalties, a management fee, an annuity, or a commission paid by a resident of Afghanistan;
10. Income from exploitation of any interest in a right to explore for, or exploit, any mineral, petroleum, or any other resources; and
11. Income from other sources in Afghanistan which is subject to tax according to the provisions of this Law.

(2) For the purposes of this Law, apart from Articles 29 and 30, the term "immovable property" in subparagraph (5) of paragraph (1) of this Article includes any benefit in a company or other entity where the value of the assets of the company or entity results principally from ownership either directly or indirectly through other persons of –

1. immovable property in Afghanistan; or
2. benefits in immovable property in Afghanistan, including hydrocarbon contracts and mining licenses and mining authorizations as defined in Chapter XII.

(3) For the purposes of this Law, apart from Articles 29 and 30, exploitation of an interest described in subparagraph (10) of paragraph (1) of this Article includes any sale of or other dealing with an interest.

20.1 Interest on loans, deposits, investments, etc., within Afghanistan include:

- a. interest on deposits of corporation and limited liability companies, but not of individuals, in banks in Afghanistan; and
- b. interest on loans to individuals, companies, permanent establishments, and subsidiaries in Afghanistan.

20.2 Dividends paid by an Afghan corporation or limited liability company will be considered to have an Afghan source and therefore subject to Afghan withholding tax.

Example: *A foreign investor owns all of the issued stock of an Afghan corporation. The Afghan corporation has accumulated Afs. 1,000,000 of earnings. The Afghan corporation distributes Afs. 1,200,000 to its shareholder. Of the Afs. 1,200,000 distribution, only Afs. 1,000,000 is considered a dividend that has an Afghan source. The remainder of the distribution is considered a return of invested capital or a gain with respect to the investor's stock. Neither the return of capital nor the gain with respect to the stock is considered to have an Afghan source.*

20.3 Salaries, wages, self-employment income, etc. for services performed in Afghanistan are considered to have an Afghan source.

Example: *A non-resident individual is employed by a UK company to perform services inside and outside of Afghanistan. The non-resident employee spends approximately 80% of his time during the year in Afghanistan. Thus, 80% of the individual's salary during the year shall be considered to have an Afghan source. This income will be subject to Afghan income tax unless exempted by a treaty or an agreement with the State.*

20.4 Rentals and royalties from any property (moveable and immovable) used within Afghanistan shall be considered to have an Afghan source.

Example 1: *A Chinese company leases trucks to an Afghan corporation. The Afghan corporation, in turn, uses the trucks to make deliveries throughout Afghanistan. The lease payment from the Afghan corporation to the Chinese company is considered to have an Afghan source.*

Example 2: *A Chinese company leases trucks to an Afghan corporation. The Afghan corporation, in turn, uses the trucks to make deliveries throughout Afghanistan and Pakistan. The lease payment from the Afghan corporation to the Chinese company is considered to have an Afghan source only to the extent it relates to the use of trucks in Afghanistan. Thus, the lease payment from the Afghan corporation to the Chinese company must be allocated between payments for use of trucks within Afghanistan and the use of trucks in Pakistan based on a reasonable measure. Examples of reasonable measures would include*

the number of miles driven in each country, or a comparison of revenues from deliveries in each country.

20.5 Gain from the sale of immovable and movable property that is physically situated in Afghanistan shall be considered to have an Afghan source. Such gains shall include:

- a. income from the ownership or interest in any immovable property, mineral deposit, or natural resources in Afghanistan;
- b. income from the ownership or interest in any franchise to do business in Afghanistan;
- c. gain from the sale of an interest in a domestic or foreign partnership, to the extent the partnership owns assets in Afghanistan;

Example 1: *A foreign investor owns a 10% interest in the capital and profits of an Afghan partnership. The Afghan partnership owns real property in Afghanistan. If the investor sells his 10% interest in the Afghan partnership, the gain (if any) will be considered to have an Afghan source. The sale of the partnership interest will have the same source as the sale of the underlying property.*

Example 2: *A foreign investor owns a 10% interest in the capital and profits of a UK limited liability partnership. The partnership owns mining properties in Afghanistan. If the investor sells the UK partnership interest, the gain (if any) will be considered to have an Afghan source.*

Example 3: *A foreign investor owns a 10% interest in the capital and profits of an Afghan partnership. The Afghan partnership owns real property in India. The Afghan partnership does not own any Afghan assets. If the foreign investor sells his 10% interest in the partnership, the gain (if any) will not be considered to have an Afghan source.*

- d) gain from the sale of stock of a corporation or limited liability company if the value of the assets of the company results principally from ownership either directly or indirectly through other persons of: (a) immovable property in Afghanistan; or (b) interest in immovable property in Afghanistan, including hydrocarbon contracts and mining licenses and mining authorizations as defined in Chapter XII.

Remark: For this purpose, the term “principally” shall mean more than fifty percent, measured by value.

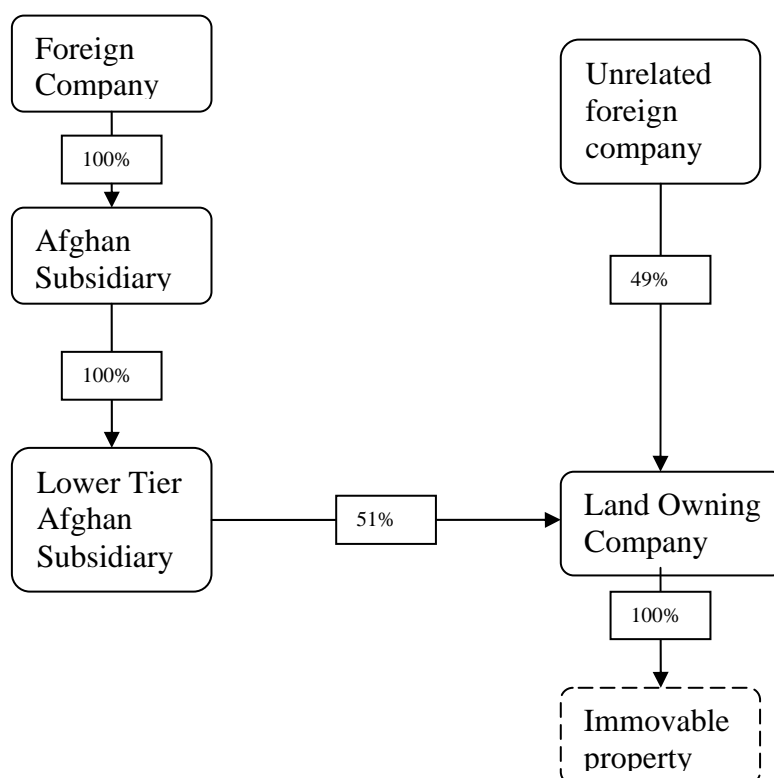
Remark: A corporation or limited liability company shall be considered to indirectly own those assets that are owned through lower-tier entities based on the value of the interest that the upper-tier entity owns in the lower-tier entity.

Example 1: *A foreign investor owns an interest in the stock of an Afghan corporation. The Afghan corporation leases some real property and owns equipment situated in Afghanistan. The Afghan corporation entered into the real property lease three years ago and the lease payments are somewhat below market. Thus, the leasehold interest is worth Afs. 300,000 to the Afghan corporation. The equipment is worth approximately Afs. 1,000,000. If the foreign investor sells the stock of the Afghan corporation at a gain, the gain will not be considered to have an Afghan source.*

Example 2: *A foreign investor owns an interest in an Afghan corporation ("A1"). A1 owns all of the issued stock of a second Afghan corporation ("A2"). A1's sole asset is the stock of A2. A2's sole asset consists of real property located in Bamiyan province. If the foreign investor sells the stock of A1, the gain will be considered to have an Afghan source, because A1's assets (owned indirectly) principally consist of real property located in Afghanistan.*

Example 3: *A foreign investor owns all of the issued stock of an Afghan corporation ("A1"). A1 owns stock of a lower-tier Afghan corporation ("A2") which represents 70% of the value of A2. A1 owns Afs. 1,000,000 that it has on deposit with Da Afghanistan Bank. A2 owns real property located in Afghanistan that is worth Afs. 2,000,000. The value of A1's property results principally from the indirect ownership of real property located in Afghanistan. This is because A1's assets consist of Afs. 1,000,000 of cash and Afs. 1,400,000 of real property (70% x Afs. 2,000,000). Thus, if the foreign investor sells the stock of A1 at a gain, the gain will be considered to have an Afghan source.*

Example 4:



The only assets owned by Afghan Subsidiary are shares in Lower Tier Afghan Subsidiary and the only assets owned by Lower Tier Afghan Subsidiary are shares in Land Owning Company and the only asset owned by Land Owning Company is immovable property eg a mining license for a site in Afghanistan.

If Foreign Company were to sell its shares in Afghan Subsidiary, Foreign Company would be treated as having sold immovable property in Afghanistan and the gain realised on the sale of shares in Afghan Subsidiary would be subject to income tax. This is because 100% of the value of Afghan Subsidiary is attributable to the immovable property further down the chain.

The same result would follow if Lower Tier Afghan Subsidiary owned 49% of Land Owning Company and Unrelated Foreign Company owned 51% of Land Owning Company. While Foreign Company now has an indirect interest in the immovable property of less than 50%, it is still the case that 100% of the value of Afghan Subsidiary is attributable to the ownership of immovable property. A sale of shares in Afghan Subsidiary in this case would be treated as a sale of immovable property.

Remark: *The tracing mechanism through interposed entities will apply in the same manner to immovable property or to benefits in immovable property in Afghanistan, including hydrocarbon contracts and mining licenses and mining authorizations as defined in Chapter XII.*

- 20.6 Commissions on sales of any kind including insurance shall be considered to have an Afghan source to the extent the sales activities take place in Afghanistan. For this purpose, consideration will be given to all of the relevant facts and circumstances. The physical location where the contract is executed will be persuasive, but not definitive evidence of where the sales activities took place.

Example: *An insurance salesman from a foreign country is in Afghanistan 30 days selling insurance to aliens in Afghanistan, some of whom belong to the foreign diplomatic corps. All commissions earned by this salesman on sales made while in Afghanistan, including those received from sales of insurance to aliens exempt from taxes in Afghanistan, are subject to income tax. The foregoing is true even if the contracts (if any) happen to be signed outside of Afghanistan. The fact that the solicitation and negotiation occurred in Afghanistan is sufficient to subject the commissions to income tax within Afghanistan.*

- 20.7 Gains from the sale or transfer of any movable property used in commercial or employment activities within Afghanistan is considered to have an Afghan source. Whether property is “used” within Afghanistan is determined based on a facts and circumstances test with due regard for the amount of time the property was used in Afghanistan compared with the amount of time that it was used elsewhere, during the period that the owner used the property.

Example 1: *A Pakistani corporation owns a number of trucks that it uses to transport goods throughout Afghanistan. The Pakistani corporation has used one truck for three years within Afghanistan. At the beginning of the fourth year, the Pakistani corporation sells the truck to a third party at a gain. The gain is considered to have an Afghan source regardless whether the sale actually occurs in Afghanistan or not.*

Example 2: *A Pakistani corporation owns a number of trucks that it uses to transport goods between Pakistan and Afghanistan. The Pakistani corporation has used one truck for three years. More than half of the time the truck was owned, it was physically used within Pakistan, not Afghanistan. At the beginning of the fourth year, the Pakistani corporation sells the truck to a third party at a gain. The gain is not considered to have an Afghan source, because the truck was predominantly used outside of Afghanistan.*

- 20.8 A management fee, annuity, or commission paid by a resident of Afghanistan is considered to have an Afghan source.

Example 1: *A UK corporation owns all of the issued stock of an Afghan corporation. Certain executives from the UK corporation provide ongoing management advice to the Afghan corporation. In exchange for this advice, the Afghan corporation pays the UK corporation a management fee. The management fee is considered to have an*

Afghan source whether or not the advisory services are actually performed in Afghanistan.

- 20.9 Income from the exploitation of any interest in a right to explore for, or exploit, any mineral, petroleum, or any other resources physically situated in Afghanistan shall be considered income from Afghan sources. To the extent that any natural or legal person generates any income (including but not limited to exploration, extraction, and/or refining) with respect to the exploitation of Afghan minerals, petroleum or other resources, the income shall be considered to have an Afghan source.

CHAPTER III

GAIN OR LOSS FROM THE SALE, EXCHANGE, OR TRANSFER OF ASSETS

Article 21 – Article 30

Gains Subject to Income Tax

Article 21. The gain from the sale or exchange of a capital asset or investment in a trade or business is subject to income tax.

21.1 Gain from a sale or exchange of capital assets is income and the difference between the amount realized and the taxpayer's cost (or cost after depreciation and related expenses of sale) of the property is income to be reported by all persons, corporations, limited liability companies and other entities.

Example 1: Ten shares of stock that cost the owner Afs. 10,000 are sold five years later for Afs. 10,000. There is no gain and no taxable income from the transaction.

Example 2: Ten shares of stock in an Afghan corporation are gifted to an Afghan resident. The Afghan resident takes a zero cost basis in the shares. If the Afghan resident sells the shares for Afs. 50,000 but has to pay fees of Afs. 5,000 to effect the sale, the Afghan resident will recognize gain of Afs. 45,000.

Example 3: On Hoot 29, 1386, a corporation sells its office building for Afs. 13,000,000. The building was purchased on Hamal 1, 1382 for Afs. 10,000,000. The annual depreciation claimed each year was Afs. 200,000; and the total deducted for the five years is Afs. 1,000,000. The expenses of sale were Afs. 50,000. The gain is computed as follows:

Sales price		Afs. 13,000,000
Original cost	Afs. 10,000,000	
Less: Depreciation	<u>1,000,000</u>	<u>9,000,000</u>
		4,000,000
Less: Expense of sale		<u>50,000</u>
Gain on sale		Afs. 3,950,000

21.2 For purposes of this Income Tax Law, the term "capital assets" means property held by the taxpayer, whether or not connected with his trade or business, but does not include stock in trade of the taxpayer or other property of a kind which would be included in the inventory if on hand at the close of a taxable year, or property held by the taxpayer for sale to customers in the ordinary course of his trade or business.

Taxable Gain of Fiscal Year

Article 22. The gain from the sale or exchange of any asset of a corporation or limited liability company is taxable income in the taxable year the asset was transferred.

22.1 Gain from **any** transfer of **any** asset of a corporation or limited liability company is taxable income.

22.2 The gain realized at the time an asset is sold is taxable income in the year of sale even though the gain in value may have accumulated gradually over a period of years.

Example: *A limited liability company has owned an apartment building 10 years during which period the value of the property has continued to increase. In 1385 the company sold the property, realizing a gain Afs. 1,000,000. The gain reflects the total increase in value during the entire 10 year period. The Afs. 1,000,000 gain is, however, taxable income in the taxable year 1385, the year that the apartment is sold.*

Tax on Transfer of Property

Article 23. (1) Gain from the sale, exchange, or transfer of the following assets is taxable income:

1. a trade or business, including goodwill;
2. a factory including equipment, machinery, buildings and land, or any part of such assets;
3. equipment used in the business of transporting persons and property; and
4. shares of stock in corporations or limited liability companies.

(2) Gain from the sale or transfer of movable or immovable property acquired by inheritance is excluded from the provisions of paragraph (1) of this Article.

23.1 The exclusion of immovable property (except factories) owned by an individual from the assets listed in Article 23 of the Income Tax Law applies only to individuals who own and hold such property for personal use. It does not exempt from taxation a profit derived from the construction and sale of buildings by individuals in the business of constructing and selling buildings. Neither does it exempt from taxation commissions received by agents or brokers who handle the sale of immovable property.

Example: *Wahid builds houses for a living. He and his family currently live in Kabul. During 1387, he builds three houses in Herat. Wahid sells his existing house in Kabul and moves his family into one of the houses that he built in Herat during 1387. He uses the house for his private dwelling. He sells the other two houses. The gain on the two Herat houses that are sold is subject to income tax under this Article. The gain on his Kabul home is not subject to income tax.*

23.2 Gain from sale of assets belonging to individuals and not covered by Article 23 of the Income Tax Law is not taxable.

Example: *Gain from sale or exchange of a generator used for personal use is not subject to income tax; but if used in connection with a trade or business, the gain is reportable as taxable income.*

a.	Cost when purchased	Afs. 125,000
b.	Plus expense of sale	<u>1,000</u>
c.	Cost when sold	Afs. 126,000
d.	Sale price	Afs. 150,000
	minus cost when sold	- <u>126,000</u>
e.	Gain	Afs. 24,000

The gain realized by the individual is Afs. 24,000 and is not taxable because the asset sold was not used in trade or business.

Remark: If the sales price is less than the cost price, a loss is incurred from the transaction. As the loss is not a loss incurred in the course of business (ie it is a personal loss), the amount of the loss is not allowed as a deductible expense.

Deduction of Expenses from Taxable Income

Article 24. Proceeds from sale, exchange, and transfer of assets, (except by inheritance), shall be reported in full. The following deductions are allowed in determination of taxable gain:

1. Cost to the taxpayer of the asset and investment sold, less the total amount allowable for its depreciation since it was acquired.
2. Expenses of sale including sales commissions, advertising expenses, legal expenses, transaction and document taxes, and other expenses of selling and transferring the asset.

24.1 Gain realized from the sale, exchange, or transfer of assets (except by inheritance or pursuant to a reorganization governed by Article 14) is determined as follows. The costs and expenses deductible by law are subtracted from the price or market value of the consideration received for the asset sold, exchanged, or transferred. The difference so obtained is the gain realized. The costs that are deductible are the price paid for the asset when it was acquired and the cost of permanent additions or improvements to the asset, less depreciation allowable. The expenses deductible are all the expenses incurred in selling, exchanging, or transferring the asset.

The depreciation allowable is:

- a. the amount that has been allowed as depreciation expense for income tax purposes; or
- b. the amount of depreciation that would have been allowed had depreciation expense been calculated for income tax purposes.

Example: *A car owned by a company is sold in 1385 for Afs. 350,000. This car was purchased in 1382 at a total cost of Afs. 420,000, and prior to its sale a new set of tires costing Afs. 60,000 had been installed on the car. If the company selling the car had charged depreciation expense at the rate of 25 per cent in each of the years 1382, 1383, and 1384, and the expense of sale and transfer was Afs. 600, the taxable gain will be computed as follows:*

a.	cost when purchased	Afs. 420,000
b.	total depreciation for three years (3 x Afs. 105,000)	<u>315,000</u>
c.	depreciation value (cost – total depreciation)	Afs. 105,000
d.	plus cost of tires	60,000
e.	plus expense of sale	<u>600</u>
f.	adjusted cost when sold	165,600
g.	sale price	Afs. 350,000
h.	minus adjusted basis	<u>- 165,600</u>
i.	gain realized	Afs. <u>184,400</u>

Tax Determination based on Market Value

Article 25. The market value of the movable or immovable asset at the time it was transferred or exchanged (except by inheritance) shall be the basis for computing the gain.

- 25.1 An exchange which is a trade of assets of equal value or in which money is only part of the consideration received may result in realization of taxable gain. Such gain is determined by subtracting the depreciated cost of the assets exchanged and the expenses of transfer from the market value of the items received in the exchange.

Example: *An individual exchanges 1,000 shares of stock in a corporation for a residence owned by an individual. Although the shares have been paying dividends regularly, there is no regular trading in these shares and no market price is available. The shares were purchased 10 years earlier at Afs. 200 per share. If the residential property is worth more than Afs. 200,000, it is clear that the shares are worth more than Afs. 200 each on the date they were exchanged for that property. If an appraisal by the Ministry of Finance shows that the property is worth Afs. 1,000,000 and could be sold for this amount, and if the expenses of transferring the stocks are Afs. 2,000, then the gain realized by the owner of the shares will be determined in the following manner:*

a. Market value of the consideration (house)	Afs. 1,000,000
b. Less cost of shares transferred (1,000 x Afs. 200)	<u>200,000</u>
c. Gain received from the transfer of stocks	Afs. 800,000
d. Minus expense of transfer	<u>2,000</u>
e. Net gain realized from the exchange of shares	Afs. 798,000

Therefore, the amount Afs. 798,000 is the net profit from the exchange of stocks realized by the person acquiring the residential property (former owner of the stocks) and he must pay income tax on it.

The provision of Article 29 of the Income Tax Law should be applied in computing the income tax on this gain because stock is intangible property. As such, it is not considered moveable or immoveable property subject to tax prescribed in Article 30.

Form of Transfer no effect on Tax Liability

Article 26. The form or nature of the transfer of movable or immovable assets shall not affect taxability of gain from the transfer, except by inheritance, which is not taxable.

- 26.1 Gain derived from the transfer of an asset is taxable, regardless of the nature of the transfer, unless the transfer is made by way of inheritance or pursuant to a transaction that qualifies as a partially or completely tax-free corporate reorganization under Article 14. For this purpose, the phrase “nature of transfer” means:
- a. transfer by sale for money;
 - b. transfer by trade for other assets;
 - c. transfer by trade for other assets and money;
 - d. transfer as a gift to close relatives or friends in consideration of friendship; and
 - e. transfer in consideration of past services or expected future services of the person to whom the “gift” is made.
- 26.2 The Income Tax Law exempts from taxation any gain from the transfer of assets by inheritance. This exemption applies both to any gain by the estate of the deceased which transfers the asset and to any gain by the heir who receives the asset. It exempts from taxation any gain that would otherwise be treated as taxable income and subject to the income tax under the Income Tax Law. The exemption also applies to transfer of land or buildings by inheritance. Notwithstanding the foregoing, the recipient of the inherited property shall take the property with a zero cost basis.

Example 1: *The property of the estate of a deceased father is divided according to law among his sons and daughters. A natural right to this property was vested in these heirs from the date of their birth. In this case, the income tax, under Article 4 of the Income Tax Law, and the one percent transfer tax, under Article 30(1) of the Income Tax Law, do not apply.*

Example 2: *The last will and testament of a property owner is carried out and his natural heirs inherit property accordingly. The will, however, provides a rather unequal distribution of property among the heirs. One heir receives land worth considerably more than the property received by the other heirs. The property received by the heirs is, nevertheless, an inheritance. The land owner exercised his legal right to have his property divided as he wished and as stated in his will. Therefore, the property received through inheritance is not subject to taxation under*

the Income Tax Law, even though distribution may be unequal among the heirs.

Example 3: *If the property owner in Example 2 had willed all or a portion of his estate to an individual who was not a natural heir, (for example, to faithful servant or a close friend), this transfer of assets would be subject to the provisions of the Income Tax Law. Any assets so transferred would be taxable income of the recipient. The estate of the deceased would also have to pay the one per cent transfer tax on the market value of any land or buildings transferred.*

Deduction of Loss Incurred from Taxable Income

Article 27. Losses from the sale or exchange of capital assets used in trade or business are deductible from the taxable income of the taxpayer in the taxable year in which the sale or exchange took place, provided that a gain from such sale or exchange would have been taxable.

- 27.1 Under certain conditions, a taxpayer may recover a portion of a loss from the sale or transfer of a capital asset used in trade or business. To do so, he must have income which is subject to taxation under Article 4 of the Income Tax Law, in the year in which the loss occurred. If he has such income, he may deduct the amount of the loss, along with other allowable deductions, in computing his taxable income. If he has no income for the year which is taxable under Article 4, he cannot deduct the loss.

Remark: An artisan whose commercial activity is taxed under Chapter XI of the Income Tax Law, and who pays the fixed tax in compliance with the Income Tax Law, cannot recover a loss from the sale or transfer of an asset used in his commercial activity.

- 27.2 When an individual suffers loss from a sale of immovable property not used in trade or business, he cannot deduct this loss even though he has taxable income in the same year as this sale took place.

Example: *An individual has taxable income from sale of shares of stock of Afs. 200,000 in 1385. He also has other taxable income from dividends, wages, etc., in the same year.*

In 1385, he sold a residential property at a loss of Afs. 100,000. He cannot deduct this loss from other income, because gain from sale of this asset would not have been subject to income tax. Instead, the sale is subject to the fixed tax provisions of Article 30 of the Income Tax Law.

- 27.3 The loss referred to in this Article is separate and distinct from the loss referred to Article 18(1)9. Losses from the sale or exchange of property may be claimed in the year incurred. Losses described in Article 18(1)9 must be claimed over a three-year period.

Non-deduction of Additional loss from Taxable Income

Article 28. Loss from sale or exchange of shares of stock is not deductible except from the gain from sale or exchange of shares of stock in the same year. For any such gain, if in excess of loss from such transactions, the excess is taxable, but if any such loss is in excess of gain, the excess loss is not deductible.

28.1 When a person suffers loss from sale or exchange of shares of stock, the person cannot deduct such loss from taxable income, except from that portion, if any, which is the gain from sale or exchange of shares of stock realized in the same year.

Example 1: *An individual sells 100 shares at a price of Afs. 1,600 per share. The shares had cost him Afs. 2,000 per share two years before. His loss on this sale is Afs. 40,000 ($100 \times (2,000 - 1,600)$). If this is the only sale or transfer of shares of stock in this taxable year, he cannot deduct any of this loss from his other taxable income. This is the case even though this person may have other taxable income from salary, dividends, etc.*

Example 2: *An individual sells 10 shares which had cost him Afs. 2,000 each, at a loss of Afs. 500 each, for a total loss of Afs. 5,000. In the same year, he sold 20 shares in another company at a profit of Afs. 400 each for a total profit from this sale of Afs. 8,000. This person can deduct his loss of Afs. 5,000 from his gain of Afs. 8,000, because the loss and the gain occurred in the same year. The remaining Afs. 3,000 of gain is taxable income.*

Example 3: *If the individual in Example 2 above would have had a gain of only Afs. 4,000, he would have been allowed to deduct only Afs. 4,000 of his Afs. 5,000 loss. In this case, there would have been no taxable income and no further deduction of his loss. Because this loss is subject to the special rule in Article 28, it cannot be carried forward under the provisions of Article 42.*

Example 4: *If the loss of Afs. 5,000 in Example 2 above had been suffered in one taxable year and the gain of Afs. 8,000 realized in a different year, none of the loss would be deductible and all of the gain would have been taxable.*

28.2 Gain or loss from sale or exchange of shares of stock is determined as follows:

- a. The amount for which the stock was sold, or the value of the assets received in exchange for the stock, or the market value of the stock on the date it was transferred, is recorded.
- b. The owner's cost of the stock is added to the expense of transfer.

- c . The figure obtained in (b) is subtracted from the figure obtained in (a). The difference shows the gain or loss from the sale or exchange of the shares of stock.

If the figure in (b) is less than the figure in (a), the difference shows the gain realized. If (b) is greater than (a), the loss from the transaction is shown.

- Remark:
1. The average cost per share shall be the total amount paid for all shares of the same kind of stock divided by the number of such shares owned at the time of transfer.
 2. The average cost per share multiplied by the number of shares transferred is the owner's cost of his stock.

Example 1: *An individual in 1385 sold 100 shares of stock in Company A at a price of Afs. 900 per share for a total sale of Afs. 90,000 with a gain of Afs. 40,000. He had no expense of sale. This was all common stock, one share worth exactly the same as any other in the same company, and all with the same voting and income rights. The owner had, however, acquired this stock at different times, and still had 20 shares left after he had sold 100.*

	<u>Cost</u>	<u>Sale</u>	<u>Gain</u>	<u>Expense of Sale</u>	<u>Net Profit</u>
<u>Purchased</u>					
1379 20 shares @ Afs. 1,000	20,000				
1381 40 shares @ Afs. 1,000	40,000				
1383 60 shares stock dividend	0				
120 shares @ Afs. 500 average price per share	60,000				
<u>Sold</u>					
1385 100 shares @ Afs. 900	- 50,000	90,000	40,000		40,000
Balance 20 shares @ Afs. 500 average price per share	10,000				

Example 2: *In 1386 the same individual purchases 50 additional shares in the same company A at a cost of Afs. 800 per share. With this purchase and the 20 shares he had left after the 1385 sale, he now has 70 shares in Company A. In 1387 he sells 75 shares for Afs. 1,000 each. His expense of sale is Afs. 3,000 and his taxable gain of Afs. 24,000 is calculated as follows:*

	<u>Cost</u>	<u>Sale</u>	<u>Gain</u>	<u>Expense of Sale</u>	<u>Net Profit</u>
Balance from Example 1 20 shares	10,000				
<u>Purchased</u>					
1386 50 shares @ Afs. 800	<u>40,000</u>				
Balance 70 shares @ Afs. 714 average share price	50,000				
<u>Sold</u>					
1387 40 shares @ Afs. 1,000					
Total	28,560	40,000	11,440	3,000	8,440
<u>Balance</u>					
30 shares @ Afs. 714	21,440				

Computing Tax on Capital Gains

Article 29. The method of determining and computing tax on capital gains is as follows:

- (1). Gain, taxable under Article 23 of this Law, from the sale or transfer of an asset owned by a person eighteen months or more is subject to the provisions of this Article if one or more of the following criteria and conditions is met:
 - the transfer (except by inheritance) of property was not a sale;
 - the asset transferred was a capital asset;
 - the asset was transferred in the sale or liquidation of a business.
- (2). The income tax of any person in any taxable year where assets were transferred under any of the circumstances described in paragraph 1 of this Article will be the product of the person's taxable income from all sources multiplied by the special rate imposed by paragraph (3) of this Article.
- (3). The special rate imposed by this Article shall be determined as follows:
 - the gain from transfer of any asset (except by inheritance) is divided by the number of years it was owned;
 - the average annual gain or gains so determined are added to all other taxable income and income tax is computed according to the rate schedule in Article 4 of this Law;
 - the tax so obtained, divided by the amount of taxable income for which it was computed, is the special rate. If the resulting rate is less than ten percent the applicable rate shall be ten percent.

29.1 The purpose of Article 29 of the Income Tax Law is equitable taxation of the income of an individual whose gain on sale or exchange of an asset may have been earned over a period of years but which becomes taxable in one year. Without this provision, the taxable income so realized would usually be taxed at higher rates (under the rate schedule in Article 4 of the Income Tax Law). Since the income received is not taxed year by year (which, for practical reasons, can not be done), all of the gain would be taxed in one year, and since the amount of income is greater, a higher rate would also be applied. Under Article 29, the accumulated gain realized is divided by the number of years it was accumulated. The average thus found is used in determining the rate to be applied to the total accumulation.

Method of Determining and Computing Tax on Capital Gains

Example: *Gain from sale of stock by an individual in 1385 is Afs. 1,000,000. The shares of this stock owned by the seller have been owned on average 4 years. Thus, average gain per year is $1,000,000/4 = \text{Afs. } 250,000$.*

The person selling this stock has taxable income from other sources of Afs. 1,300,000 (after deductions), and his tax for 1385 will be calculated as follows:

a.	1385 taxable income from other sources	Afs. 1,300,000
b.	Average gain per year during period stock was held	<u>250,000</u>
c.	Total	Afs. 1,550,000
d.	Tentative tax from Article 4 of the Law	175,000
e.	Special rate is $175,000/1,550,000$	11.29%
f.	1385 taxable income other sources	1,300,000
g.	Taxable income from sale of shares	<u>1,000,000</u>
h.	Total taxable income	2,300,000
i.	Tax ($2,300,000 \times 11.29\%$ *)	Afs. 259,670

** As the special rate of 11.29% is more than the 10% minimum percentage prescribed, the rate of 11.29% applies.*

Remark: *If the special concession rate above had not been applied, the tax on Afs. 2,300,000 would have been Afs. 325,000.*

- 29.2 Corporations and limited liability companies may not use this method. There is no tax advantage in using Article 29 for corporations and limited liability companies, because they are taxed at a uniform rate of 20 percent. Thus, the averaging of gain would not change the rate of their tax.
- 29.3 The gains from assets owned less than 18 months do not qualify for concessional treatment under this Article.

Tax on sale of Movable or Immovable Property

- Article 30 (1) Except by inheritance and as mentioned in Article 23 of this Law, the price of sale or transfer of immovable property is subject to a fixed tax of one percent at the time of transfer of ownership in lieu of income tax.
- (2) The price from sale or transfer of movable property or a vehicle is subject to a fixed tax of two percent at the time of transfer of ownership in lieu of income tax.

30.1 The sale or transfer of land and buildings owned by corporation or limited liability company is not subject to the tax imposed by Article 30 of the Income Tax Law. Corporations and limited liability companies are required to pay income tax on all gains from sales and transfers of assets according to Article 21 of the Income Tax Law.

30.2 The one percent tax imposed by Article 30(1) of the Income Tax Law does not apply to land sold by the Government of Afghanistan or its municipalities in the exercise of ordinary governmental powers.

30.3 The tax imposed by Article 30(1) of the Income Tax Law applies to sale or transfer of any immovable property such as land owned by an individual, individuals in ordinary partnerships, or by families. Leases that run from year to year or for terms of 10 years or less are not, however, considered to be transfers of land rights for purposes of this tax. Leases with a term in excess of 10 years are considered transfers subject to this tax.

Example 1: A landowner leases his agricultural land to a farmer who pays a specified part of the produce of the land each year as rent. The tax provided in Article 30 of the Law does not apply.

Example 2: A tract of land in a city is owned by an individual who leases the tract in a 99 year renewable lease to a company that builds an industrial plant on the land. This transfer of land rights is taxable. The tax will be one percent of the market value of the land.

30.4 Whenever two individuals exchange properties, each property is taxed as a separate transaction.

Example: Azziz owns a parcel of land in Kabul Province that he does not use in his trade or business. Wahid owns a parcel of land in Herat Province that he does not use in his trade or business. Azziz and Wahid agree to exchange their parcels of land. Both Azziz and Wahid must pay a tax equal to 1% of the value of the land transferred.

30.5 A transfer of a partnership interest is treated as a transfer of the underlying property owned by the partnership.

Example: Azziz is an Afghan resident who owns a 10% interest in an Afghan partnership. The remaining 90% of the partnership is owned by Azziz's brother, Wahid. Wahid is also an Afghan resident. The Afghan partnership owns real property located in Kandahar Province that is not used in a trade or business. If Azziz sells his 10% interest, Azziz is deemed to have sold the underlying real property owned by the partnership. Azziz is therefore subject to the 1% transfer tax in Article 30(1) of the Income Tax Law.

- 30.6 The sale or transfer of movable property or a vehicle is subject to a fixed of two percent of the sale price (or market value if the sale price is different to market value). Any individual who sells or transfers the ownership of a motor vehicle will be required to pay this fixed tax.

Example: Feroz owns a motor vehicle. He purchased the motor vehicle two years ago for Afs 130,000. Feroz agrees to sell the motor vehicle to Najib for Afs 150,000. Feroz will be required to pay fixed tax of 2 percent of Afs 150,000 ie Afs 3,000 at the time that the motor vehicle is sold.

Remark: A motor vehicle sold by a limited liability company or a corporation will not be subject to tax under this Article. Rather, the gain or loss on the sale of the motor vehicle will be subject to income tax under Articles 22 and 27.

CHAPTER IV

PARTNERSHIPS

Article 31 – Article 35

Definitions

- Article 31.
1. A partnership is an association of two or more persons joining under an agreement, in accordance with the provisions of the relevant laws, to carry on business and share the profit or loss.
 2. A partner is a person who has a share in the partnership.
 3. The partnership agreement is the body of provisions agreed to by the partners under which they operate the partnership.
 4. A general partnership (Sherkat-Tazamoni) is one in which the partners are liable for payment of all debts of the partnership individually and collectively.
 5. A special partnership (Sherkat-Tazamoni-Mekhtalet) is one in which one or more partners have unlimited liability for debts of the partnership and the rest of the partners have liability limited to their shares of capital in the partnership.
 6. A limited liability company (Sherkat-Mahdudul Masseliat) is a partnership in which the partners are not individually liable for debts of the company but each partner has liability limited to his shares of capital in the company.
 7. A corporation (Sherkat-Sahami) is a partnership which has its capital determined and divided by shares and liability of each partner is limited to his shares.

31.1 Corporation shares are negotiable. They may be sold by the owner without the consent of the remaining shareholders. The limited liability company is different. Shares of the partners (shareholders) in a limited liability company are not negotiable. The company determines whether a partner (shareholder) can sell his shares or not, and to whom his share may be sold. A limited liability company is taxed like a corporation. Please refer to Article 32 of the Income Tax Law and the regulations issued pursuant thereto with respect to the taxation of limited liability companies.

31.2 To have a partnership, two or more persons must join together pursuant to an agreement to carry on a business and share the profits thereof.

(a) The parties are not required to formalize their agreement in writing. The partnership "agreement" can be created through the course of conduct of the parties.

Example: *Adib and Wahid operate a series of fruit stands in Kabul City. They never formalize their agreement in writing. Nevertheless, every day, Adib provides the carts that are necessary to display the fruit and he provides the services of various vendors. Wahid provides the fruit to*

the vendors. Adib takes 60% of the profits (after expenses) from the venture and Wahid takes 40% of the profits (after expenses). Adib and Wahid are joined together in a partnership, even though they do not have a formal written agreement.

- (b) Mere co-ownership of property is usually not sufficient, in itself, to create a partnership. Instead, there must also be a sharing of profits and losses.

Example: *Adib and Wahid are brothers. They inherited a parcel of land in Zabul Province from their father. Adib and Wahid jointly own the property, but the property is undeveloped. Neither Adib nor Wahid have any intention of developing the land. Instead, they intend to hold it for a period of time and eventually sell it. They may sell it separately or they may sell it jointly. Under these facts, Adib and Wahid are not joined together in a partnership.*

- 31.3 The partnership income (and loss) is reportable by the individual partners at the end of the taxable year whether the income is distributed or not. Each partner must recognize his or her distributive share of partnership income or loss.

Example 1: *Adib is an Afghan resident. Adib owns 15% of an Afghan partnership. Wahid is an Afghan resident. Wahid owns 85% of an Afghan partnership. The partnership generates Afs. 1,000,000 of profit during the year. The partnership does not make any distribution of profits during the year. Adib must recognize Afs. 150,000 of profit on his tax return. Wahid must recognize Afs. 850,000 of profit on his tax return.*

Example 2: *Adib is an Afghan resident. Adib owns 15% of an Afghan partnership. Wahid is an Afghan resident. Wahid owns 85% of an Afghan partnership. The partnership generates Afs. 1,000,000 of loss during the year. The partnership does not make any distributions during the year. Adib must recognize Afs. 150,000 of loss on his tax return. Wahid must recognize Afs. 850,000 of loss on his tax return.*

Limited liability company and special partnership

- Article 32. (1) A limited liability company is subject to the same provisions of this Law as corporations (Sherkat-Sahami). Partners in such companies are considered shareholders, and distributions of earnings are considered dividends for purposes of this Law.
- (2) A special partnership is subject to the same provisions of this Law as a general partnership.

- 32.1 The provisions of the Income Tax Law relating to shareholders of corporations apply to partners in limited liability companies. Similarly, provisions relating to dividends paid to shareholders by a corporation also apply to distributions of earnings to the partners in a limited liability company.

Example: A limited liability company has earnings of Afs. 1,000,000 in a taxable year. Afs. 900,000 in cash is distributed to the partners and Afs. 100,000 is retained by the company. The net income tax of the company will be 20 percent of Afs. 100,000, that is, Afs. 20,000; and the tax withheld from dividends will be 20 percent of Afs. 900,000, that is, Afs. 180,000.

- 32.2 The partners who have a limited liability in a special partnership will also have a limited liability with respect to fixed taxes under Chapter XI of the Income Tax Law. The fixed tax can be paid from any share of such partners to the extent of their earnings (undistributed or distributed) or assets, or from the partners who have an unlimited liability.

Example: After audit, it is determined that a special partnership owes an additional tax of Afs. 100,000 for the taxable year 1385. The special partnership made no profit in 1385 nor did it make any distribution of earnings in that year. There are no assets available for payment of this additional tax. In this situation the partners with limited liability cannot be assessed for any part of the tax, but the partners with unlimited liability are themselves liable for the entire tax.

Remark: If the partnership had assets available for the payment of the tax, or if it had distributed assets (earnings) in the same year (1385), the assessment of additional tax would be made first against the remaining assets and assets distributed that same year. If the tax liability were, nevertheless, not fully satisfied, the balance unpaid would be the liability of the partners having unlimited liability

General Partnerships

Article 33. A general partnership as a legal entity is not subject to the income tax imposed by this Law. Partners as natural persons are liable for income tax only in their separate and individual capacities. The income of the general partnership is taxable as income of the partners individually, each of whom is required to include his share of the partnership income in his taxable income.

33.1 Income of a general partnership is exempt from income tax if both of the following conditions are met:

- a. its income is from commercial activity subject to a fixed tax;
- b. such fixed tax is in lieu of tax on income according to Chapter XI of the Income Tax Law.

Such income of a general partnership is exempt whether distributed to the partners or not distributed.

Remark: A business establishment is taxed under provisions of Chapter XI of the Income Tax Law and is owned and operated by a general partnership which pays the fixed tax. In some years profit from commercial activity of this establishment is distributed to the partners, and in some years it is not. The partnership's income is exempt from taxation.

33.2 An Afghan resident partner can receive a distribution of Afghanis from a partnership without tax to the extent of the partner's share of his basis in the partnership.

Example 1: Azziz and Wahid are equal partners in an Afghan partnership. They each contributed Afs. 500,000 to the partnership upon the formation of the partnership. During the year, the partnership generated Afs. 200,000 of profit. At the end of the year, before considering distributions, Azziz and Wahid's share in their partnership interests increased from Afs. 500,000 to Afs. 600,000. During the year, the partnership distributed Afs. 50,000 to each partner. Azziz and Wahid must each recognize Afs. 100,000 as their distributable share of partnership profit. Azziz and Wahid do not have to recognize the Afs. 50,000 that is distributed to them during the year. After the distribution, Azziz and Wahid's share in the partnership will each be reduced to Afs. 550,000.

Example 2: Azziz and Wahid are equal partners in an Afghan partnership. They each contributed Afs. 500,000 to the partnership upon the formation of the partnership. During the year, the partnership generated Afs. 200,000 of profit. Azziz and Wahid must each recognize Afs. 100,000

as their distributable share of partnership profit. At the end of the year, Azziz and Wahid's basis in their partnership interests increased from Afs. 500,000 to Afs. 600,000. The partnership did not make a profit or a loss during its second year of operation, but it did distribute Afs. 60,000 to each partner. After the distribution, Azziz and Wahid's basis in the partnership was reduced to Afs. 540,000.

- 33.3 If a partner in a partnership receives Afghanis in excess of the partner's basis in the partnership, the partner must recognize gain with respect to his or her partnership interest.

Example: *Azziz and Wahid are equal partners in an Afghan partnership. They each have a basis of Afs. 200,000 in the Afghan partnership. Due to accelerated depreciation deductions, the partnership generates a significant amount of cash without generating any significant taxable earnings. The partnership distributes Afs. 210,000 to each of Azziz and Wahid during the first year of operation. Azziz and Wahid must each recognize a Afs. 10,000 gain (Afs. 210,000 – 200,000).*

Determination of net income

Article 34. Every general partnership is required to make an annual report of all its receipts, expenses, and disbursements, and to determine its net income in the same manner as an individual. The partnership is required to report separately for each partner his share of the following items:

1. the net income or net loss;
2. the gains or losses from sale or exchange of movable and immovable property; and
3. salary, interest, dividends, advances, or similar payments.

- 34.1 All partnerships (general and special) must file an annual report whether engaged in activities covered by fixed taxes in lieu of income tax or not. A copy of the report of the partnership must be filed by each partner at the tax office of the district in which he is required to file his income tax return.
- 34.2 An individual engaged in business activities subject to fixed taxes in two or more locations which are taxed through different tax offices shall pay the fixed tax of each establishment at the tax office of the district in which such establishment is located. Such individual, if required to file an income tax return, shall file such return at the tax office in the district of either his permanent residence or at the office from which he received his commercial license. This rule shall also govern the filing of the income tax return of an individual who is a partner in a partnership.
- 34.3 A partnership annual report is required even though the firm has no taxable income for the taxable year. Each partner of the partnership must report his or her respective shares of partnership profit at the end of the taxable year whether the profit has been distributed or not.

Distribution of Receipts

Article 35. The income, expenses, and net earnings of a general partnership shall be deemed to have been shared by the partners according to the terms and conditions of the general partnership agreement.

35.1 Where the partnership agreement is verbal (or the partnership agreement is unclear) and the partners disagree about the division of income, the Ministry of Finance will apportion the assets, liabilities, and undistributed income equally unless facts and circumstances indicate otherwise. Factors that the Ministry may look to include, but are not limited to, the following:

- (a) The fair market value of the relative contributions of the partners.
- (b) The method in which profits and losses were shared in prior years.
- (c) The manner in which distributions were shared between the partners.

Example: *Jamal and his brother Wahid agree to begin selling vases and artistic crafts in Kabul. Jamal allows the business to use his store located on Shar-e-Now street and Wahid transfers various vases that he created to the store. The brothers never document their agreement. The store is worth Afs. 4,000,000 and Wahid's vases are worth Afs. 1,000,000. At the end of the first year of operation, the store is very successful. The brothers begin to argue about how much of the business they own and how much income each partner is entitled to. In this case, the Ministry of Finance may, for example, look at the relative contributions of the two brothers and conclude that Jamal owns 80% of the partnership and Wahid owns 20% of the partnership.*

CHAPTER V

RULES FOR ACCOUNTING

Article 36 – Article 41

Maintenance and preservation of records

Article 36. All natural or legal persons with taxable income in a taxable year shall keep records of all transactions, of all movable and immovable property, and of all income. Such records shall be preserved by the owner and be available to the Ministry of Finance upon request.

36.1 All corporations, limited liability companies, and partnerships are required to keep records whether they have taxable income or not.

36.2 Individuals who have no taxable income are not required to keep records under any provision of the Income Tax Law. This includes:

- a. individuals whose only income is from commercial activities taxed under fixed taxes that are in lieu of income tax;

Remark: Small shopkeepers who pay taxes under Chapter XI of the Income Tax Law.

- b. individuals whose income is solely from agriculture;
- c. individuals with income less than their own personal exemption of Afs. 12,500 per month; and
- d. individuals with income from any source exempt from taxation, or individuals who, in addition to exempt income, also have income subject to taxation but in amounts less than Afs. 12,500 per month.

Example: *An individual receives Afs. 12,000 from sale of wheat and Afs. 25,000 from sale of grapes produced on his own land. He also has income from a fruit shop which is taxed under Chapter XI of the Income Tax Law. A third source of income is salary from an employer in the amount of Afs. 1,000 per month.*

Since the only income subject to income taxation is his salary and since his salary of Afs. 12,000 per year is less than the minimum amount required to be subject to income tax, this individual is not required by this Law to keep records.

36.3 Although an individual has no taxable income from his usual business, he is required to keep records and documents covering any other transaction that may result in taxable gain.

Example: *A shopkeeper pays a fixed tax annually under provisions of Chapter XI of the Income Tax Law. But he also receives a large dividend with respect to shares of stock that he owns. The dividend is subject to income tax. Although the individual does not have to keep records with respect to the*

activities of his shop, he has to keep records with respect to the dividend that he receives.

- 36.4 Records and documents must be maintained but need not be surrendered. Instead, the person or entity required to keep records and documents must produce these for inspection, examination, copying, etc., whenever the Ministry of Finance asks for them.

Example: *A company taxed on its net income is asked to deliver its business records to the Ministry of Finance. This company may refuse to deliver originals of its records to the Ministry, but it must make all its records and documents available at its own office for inspection, audit, reproduction, etc., by auditors of the Ministry of Finance.*

- 36.5 Records and documents must be kept for a period of 5 years after the end of the tax year to which the records and documents relate.

Accrual method of accounting

Article 37 Corporations and limited liability companies shall compute their income using the accrual method of accounting which recognizes income and expenses when due.

37.1 The “accrual method of accounting” means any recognized double-entry system of accounting which includes a procedure for adjustments that will show income separately for a given period and financial position precisely for a given date.

37.2 Corporations and limited liability companies must use the accrual method of accounting in accordance with accepted accounting principles. An accurate and well-documented accounting method is indispensable for efficient management.

Example: *A company loans Afs. 1,000,000 at eight percent interest. Principal and interest are due one year after date of loan. The taxable year ends before the borrower repays the loan with interest. Under the accrual method, the interest earned by the end of the solar year will be reflected in the total income for that taxable year. Thus, if in the year 1385 this loan was made at the end of Saur, accrued interest income for the period between the end of Saur and the end of Hoot of the year 1385 (that is, the income for the ten months of the year 1385) will be included with 1385 income, even though it was not received in 1385. The interest income is computed as follows:*

a. Since the interest rate is eight percent per year, the interest for one year from the end of Saur, 1385, to the end of Saur, 1386, will be equal to the product of Afs. 1,000,000 and eight percent, namely:

$$\text{Afs. } 1,000,000 \times 8/100 = \text{Afs. } 80,000$$

b. Because only 10 months of interest are recognized in the year 1385, only 10/12 of the interest is attributable to 1385 and this is equal to:

$$\text{Afs. } 80,000 \times 10/12 = \text{Afs. } 66,667.$$

37.3 An accrual basis taxpayer recognizes income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.

(a) Prepayments for goods or services in the form of a deposit are generally not included in income until the good is sold or the service is delivered. For this purpose, a deposit is an amount of money that is paid in advance, but which may have to be refunded if the recipient fails to provide the required goods or perform the required services.

Example: An Afghan corporation provides painting services to various businesses and home owners in Mazar-e-Sharif. The Afghan corporation typically receives Afs. 200,000 as a deposit to paint a large building. The corporation expects to receive an additional Afs. 1,000,000 in six months once it has completed painting the building. The Afghan corporation does not have to accrue the income until after the building has been painted.

- (b) If the taxpayer is required to perform services over a period longer than one year, then the taxpayer is required to use the percentage of completion method to determine the amount of income associated with the project that must be recognized each year. Under the percentage of completion method, the taxpayer makes a reasonable estimate of the total costs that it expects to incur over the course of the contract. The taxpayer determines the amount of costs that the taxpayer incurred during the tax year. The taxpayer divides the amount of costs incurred by the taxpayer during the year by the total estimated costs for the project. This fraction is then multiplied by the revenue that is expected to be generated from the project.

Example 1: An Afghan corporation enters into a contract to construct a building in Herat. It will take three years to complete the building. The Afghan corporation estimates that it will incur Afs. 30,000,000 to construct the building. The contract provides that the Afghan corporation will be paid in periodic installments over the life of the contract. The total amount that the Afghan corporation will be paid over the contract term is Afs. 40,000,000. Because the contract calls for the corporation to provide construction services over a period exceeding one year, the corporation must use the percentage of completion method in accruing its income under this contract.

If, in the first year, the corporation incurs Afs. 6,000,000 of costs, then the corporation must accrue $1/5$ ($6,000,000 / 30,000,000$) of the revenue associated with the contract or Afs. 8,000,000. The profit recognized in the first years is thus Afs. 2,000,000 (Afs 8,000,000 – 6,000,000)

Example 2: The facts are the same as in Example 1, except that in the second year, the Afghan corporation revises its cost estimates. It now believes the total cost to complete the project will be Afs. 35,000,000. In the second year, the Afghan corporation incurs Afs. 5,000,000 of expenses. The Afghan corporation must accrue $1/7$ of the revenue ($5,000,000/35,000,000$) or approximately Afs. 5,714,000. The profit is thus Afs. 714,000 in the second year.

Remark: Small contracts need not be subject to the percentage of completion method. For this purpose, a small

contract is a contract for which the total consideration to be paid is less than Afs. 15,000,000.

37.4 An accrual basis taxpayer recognizes an item of expense when: (i) the liability becomes fixed; and (ii) all the events have occurred that establish both the nature and amount of the liability.

a) A liability is fixed when it is certain to arise.

Example 1: *An Afghan corporation operates a computer supply store in Herat. The Afghan corporation sells 10 computers to a business operating in Herat for Afs. 1,000,000 during 1386. On the last day of Hoot in 1386, the purchaser informs the Afghan corporation that one of the computers is defective. The purchaser asks for a refund of Afs. 2,000. The Afghan corporation disputes the liability. The Afghan corporation cannot claim a deduction for the Afs. 2,000 liability on its 1386 income tax return, because the liability is not fixed.*

Example 2: *The facts are the same as in Example 1, except that on the 10th day of Saur, 1387, the Afghan corporation and the purchaser agree that the purchaser is entitled to a Afs. 1,000 refund. Even though the settlement is reached before the Afghan corporation files its tax return for 1386, the Afghan corporation cannot deduct the expense, because the liability did not become fixed during the 1386 taxable year.*

b) All events required to establish the nature and amount of the liability will be satisfied when all of the events that give rise to the liability have occurred.

Example 1: *An Afghan corporation operates a shop in Herat. The corporation employs an Afghan resident individual to wash its windows once a month. The Afghan corporation hires the individual in the middle of Hoot in 1386. The first washing isn't due to occur until the 10th day of Hamal, in 1387. The Afghan corporation cannot deduct the expense of the first washing in 1386, even if the corporation pays the window washer in advance, because all of the events that generate the liability (i.e., the washing of the windows) will not occur until the following year. Until the windows are actually washed, the corporation's liability will not arise.*

Example 2: *An Afghan corporation operates a shop in Kabul. The shop sells cars and trucks to the public. The Afghan corporation hires an Afghan resident individual to install air conditioning units in its showroom. The corporation and the individual agree that the air conditioning units will be installed no later than the last day of Hoot, 1385. The corporation and the individual agree that the corporation does not have to pay the individual until 45 days after the date the work is completed. The individual installs the air conditioning units as requested, but does not complete the job until the last day of Hoot, 1385. Even though the corporation does not have to pay the individual*

until 1386, the corporation is entitled to deduct the expense associated with the installation of the air conditioning units because the liability is “fixed” and the “all events” test has been satisfied by the end of 1385.

Cash Method of Accounting

Article 38. A person shall compute his taxable income using the cash method of accounting at the time of income receipt and expense payment. The Ministry of Finance may permit a taxpayer to compute his taxable income using the accrual method of accounting. Corporations and limited liability companies are excluded from this provision.

Deductions for depreciation are allowable in accordance with the Income Tax Manual.

38.1 According to the cash method of accounting, all deductible expenses and costs paid during the taxable year are subtracted from the total amount received in cash (or its equivalent) during the taxable year, and income is computed including (1) the change in inventory from the beginning of the year to the end of the year, and (2) the depreciation taken during the year.

Example 1: *If a trader keeps his records on the cash basis, the following steps are to be taken to find the net cash income of his business:*

- a. *all cash receipts are recorded when received, and sales totaled for the taxable year; Afs. 1,572,000*
- b. *the value of the inventory at the beginning of the year is recorded; Afs. 11,000*
- c. *all purchases of goods for resale are recorded when paid for and totaled for the taxable year; Afs. 460,000;*
- d. *the amounts from (b) and (c) above are added; Afs. 471,000*
- e. *the value of the inventory at the end of the year (closing inventory), Afs. 87,000, is determined, to take into account the increase (or decrease) during the year (as required by Article 40 of the Income Tax Law).*

Remark: *The closing inventory for one year becomes the beginning inventory for the next year.*

- f. *from the total amount obtained in (d) above, the amount obtained in (e) above is subtracted to obtain the value of goods sold during the year; Afs. 384,000*
- g. *the amount obtained in (f) is subtracted from the amount in (a) to get the gross cash profit; Afs. 1,188,000*
- h. *all cash business expenses are recorded when paid and totaled for the year; Afs. 66,000*

- i. *the total of depreciation expenses of fixtures, equipment, buildings, etc., used in business (even though not cash expenditures) is computed (but only to the extent specifically allowed during the year); Afs. 1,800*
- j. *the amounts obtained in (h) and (i) are added; Afs. 67,800; and*
- k. *the amount obtained in (j), Afs. 67,800, is subtracted from the gross profit (the amount obtained in (g)) to obtain the net cash income; Afs. 1,120,200.*

The following is a summary of the previous example:

a.	Total cash receipts from sales		Afs. 1,572,000
b.	Beginning Inventory	Afs. 11,000	
c.	Cash paid for purchases	<u>460,000</u>	
d.	Sum of (b) and (c)	Afs. 471,000	
e.	Ending inventory	<u>87,000</u>	
f.	Cost of goods sold during the year (d-e)		<u>384,000</u>
g.	Cash gross profit (a-f)		Afs. 1,188,000
h.	Total business cash expenses	Afs. 66,000	
i.	Depreciation (non-cash expense)	Afs. <u>1,800</u>	
j.	Sum of (h + i)		<u>67,800</u>
k.	Cash net income (g - j)		Afs. 1,120,200

- 38.2 Use of the accrual method of accounting by a taxpayer is to be preferred. Any individual willing and able to use this method, should be given permission to compute his income this way.
- 38.3 Where income is derived from a business which does not require an inventory of goods, products, or materials, etc. nor use equipment, fixtures, buildings, etc. owned by the individual, net income under the cash method of accounting is cash received in the business minus cash paid out for business expenses.

Example: *A broker selling real property for the owners receives commissions based on prices received for the properties. He has business expenses such as newspaper advertising, taxi fares in contacting owners and prospective buyers, cost of printed materials, office rent, telephone and electricity costs, wages of office boy, and other similar expenses. If all commissions received during the taxable year total Afs. 300,000 and all expenses paid during the taxable year total Afs. 25,000, his cash income is Afs. 275,000, which is also his net income computed under the cash method of accounting. Although part of the Afs. 300,000 may have been earned during a previous year, under the cash method the income is reported when received.*

- 38.4 A taxpayer may request that it be permitted to change to an accrual method of accounting by filing a request for permission with the Ministry of Finance. If a change to an accrual method of accounting is approved by the Ministry of Finance, the income of the taxpayer earned in prior years but not received must be added, and the expenses incurred in prior years but not paid must be

- 38.5 Any additional tax due to the change in the accounting period or methods shall be paid with the amended return. Any reduction in tax computed according to an amended return filed in connection with the same changeover shall be subtracted from any income tax owing on income of a subsequent year.

Example: An amended return for the year 1385 is filed together with the first return on accrual method for the year 1386 in Sonbula 1387. Any additional tax computed in the amended return is due at that time, and no interest or penalty is charged if this tax is paid before the end of the third month of 1387. Any reduction in tax indicated by the amended return may be subtracted from the 1386 tax or, if no tax is due from 1386, or if the tax due is less than the reduction, it can be deducted from the taxes for subsequent years.

- 38.6 In order to make a change in the accounting method, all taxpayers must make a written request to the Ministry of Finance no later than 30 days before the end of the taxable year.

Form and content of records

Article 39. The Ministry of Finance is authorized to prescribe the records that shall be kept by any taxpayer or class of taxpayers to reflect income clearly and to require such reports as it deems necessary to administer the income tax.

- 39.1 The Ministry of Finance is authorized by Article 39 of the Income Tax Law to prescribe the records to be kept and the reports to be required of any taxpayer or class of taxpayers. The Ministry is authorized to insist on the completeness of records and verifiability entries in order to audit a taxpayer's records. In general any double-entry system of accounting recognized and accepted by societies of professional accountants is prescribed for all corporations and limited liability companies. The accounting records must be kept current at all times, with transactions being recorded as they occur. The accounts shall be such that detailed financial statements may be readily prepared showing the financial position of the company as of a given date (balance sheet), and the operations of the company over a given period (profit and loss statement).
- 39.2 The Ministry of Finance requires that all corporations, limited liability companies and other entities liable to pay annual income tax maintain the following accounting records:
- a. journals
 - b. ledgers
 - c. inventory and stocktake records
 - d. asset register
 - e. banking and financial transaction information
 - f. legal documents, including contracts
 - g. statements, invoices and receipts
 - h. income statements
 - i. balance sheets.

Inventory at the close of year

Article 40 Inventories of goods, products, and materials used in business shall be taken at the close of each taxable year and priced at cost or market value, whichever is lower. All taxpayers engaged in manufacturing, trade, or other businesses are required to take inventories on such basis as the Ministry of Finance may prescribe.

40.1 An inventory is an enumeration of all items and quantities of goods, products, and materials on hand at a given time. For purposes of accounting, inventories are expressed in terms of money value. Article 40 of the Income Tax Law requires that an inventory be “priced at cost or market value, whichever is lower.” By market value it is meant the price that the owner can reasonably expect to sell the item for in the usual course of business. As a general rule, most items or quantities included in an inventory will be priced at cost, which is the total of invoice price, freight, insurance, duties, etc., paid by the owner. Market value will ordinarily be higher than cost and therefore cannot be used. The following examples where cost is higher than market value are exceptions to this:

- a. where a very similar item can now be purchased at a greatly reduced cost;
- b. where an improved item is available at a cost that reduces the market value of the older item on hand;
- c. where an item cannot be sold, even at cost, as happens when the businessman misjudges the wants of the customers;
- d. where the item has been damaged, has deteriorated, or has gone out of fashion;
- e. where a tax paid by the owner on the item has been discontinued or reduced—such as customs duties;
- f. where circumstances are such that they clearly reduce the prices to be expected to be less than cost.

Inventories accurately enumerated and realistically priced are essential to any determination of net income.

40.2 The taxpayer shall take an inventory at the close of the taxable year and retain the inventory record as substantiation of the value reported in his income tax return. Each item or kind of material shall be described together with the quantity and weight. The unit cost or cost per item shall be noted and the value of all units of given kind extended on the record. The sum of all extensions is the value of the inventory at the end of the year.

Example:

<u>Number of Units</u>	<u>Description of Item</u>	<u>Unit cost</u>	<u>Market value if Lower</u>	<u>Total Value (Afs)</u>
6	No. 1506 6 Phillips Radios	1,200		7,200
22	No. 215412 Condensers	12		264
1	No. 168 2 Phillips Tape Recorders	10,400		10,400
1	1955 obsolete phonograph	7,500	2,500	2,500
112	CDs RCA	180		20,160
231	CDs Vivendi	60		13,860
...
	Total Carried Forward			54,384

- 40.3 The inventory shall be taken at the close of each taxable year. At the end of the last business day of the taxable year enumeration of the items and quantities on hand shall begin and continue until all items have been listed and counted, all materials measured and the quantities on hand noted. The inventory is to be taken after the final transactions of the year are completed and before selling or buying in the new year begins. Nothing should move out of or into the stock of merchandise while the enumeration takes place.

Example: *A shop is open for business through Hoot 30, 1385. The next two days the shop is closed and no business is conducted. During that time all goods on hand are counted and listed on inventory record sheets. Before business resumes on the third day after closing, every item of merchandise on hand has been recoded. In this way the cost of goods sold during the taxable year can be determined. No sales recorded for the new year will have been taken out of the stock before it was enumerated.*

Remark: *There is no requirement that a taxpayer physically close its business if the taxpayer can establish what the inventory at the end of the year is.*

- 40.4 Purchases of goods may be recorded as the system of accounting observed requires. The cost of goods sold, however, must not include purchases not yet received and included in inventory, unless adjustment is made for such purchases.

Example: *An Afghan resident individual operates an import business and has the following situation at the close of 1385. Because the business is operated by an individual, the business uses the cash basis of accounting.*

His cash purchases for the year total Afs. 600,000. This total includes cash paid in advance in the amount of Afs. 40,000 for goods that have not yet arrived and are not a part of his stock of goods on hand. This amount should be added to his closing inventory as follows:

a.	Total value of inventory at the end of 1385	Afs. 67,500
b.	Advance payment on shipment ordered in 1385 not received by end of year	<u>40,000</u>
c.	Total inventory plus advances at the end of 1384	Afs. 107,500

By adding his closing inventory for 1384 to his purchases of Afs. 600,000 and subtracting Afs. 107,500, he will have his cost of goods sold in 1385. At the end of the next year 1386 he can use Afs. 107,500 as his beginning inventory. Additional expenses on the shipment, such as import duties, trucking charges, etc., will be recorded for 1386 as payments are made.

Tax determination of two or more businesses

Article 41. In the case two or more organizations, trades or businesses are owned or controlled directly or indirectly by the same natural or legal person, the Ministry of Finance may distribute, apportion or allocate receipts, deductions or credits between or among such organizations, trades or businesses to reflect accurately the taxable income and prevent evasion of taxes.

- 41.1 The authority provided by Article 41 of the Income Tax Law makes it lawful for the Ministry of Finance to adjust the tax position of entities or businesses controlled by the same person when such action is necessary to prevent tax evasion. However, this course of action should be exercised with restraint. Unless there is an evasion of tax, separate organizations are allowable and there is no need for the allocation and distribution authorized in Article 41 of the Income Tax Law.

Example 1: *The shareholders of Company A own the issued stock of Company B. Control is identical and the majority of each Board of Directors is comprised of the same individuals. Separate management and function for each company exist, however, and no tax saving is noted. If the profits of both were combined, the tax rate would be the same. There is no exemption in either case, so taxes are the same with separated organizations as they would be if the activities of both were carried on by one company. In this case, there is no need for the Ministry to reallocate income between Company A and Company B.*

Example 2: *Azziz is an Afghan resident individual that owns all of the issued stock of two Afghan corporations, Corporation A and Corporation B. Both corporations are engaged in the business of harvesting and processing timber. Corporation A has younger employees and so incurs lower labor costs, than Corporation B. Corporation A has historically always generated a profit. Corporation B, however, has a net operating loss that it is carrying forward. Corporation A decides to sell some unprocessed timber to Corporation B at price that is lower than Corporation A's cost so that Corporation B can process the timber, generate a profit, and utilize some of its net operating loss. The Ministry has the right under these facts to reallocate income away from Corporation B and to Corporation A.*

- 41.2 When tax saving is being realized by an owner or owners because of division of business activities between separate organizations owned, controlled, or directed by the same owner or owners, the Ministry of Finance is authorized to prevent tax evasion by allocating the income of the organization to their owners.

Before any allocations are made, thorough investigation must determine the following facts:

- a. the identity of shareholders or partners in each entity;
- b. the number of shares (or the amount of capital) held by each shareholder (or partner) in each entity;
- c. the identity of the members of the Boards of Directors of each entity;
- d. the identity of management personnel of each entity;
- e. the nature of the business activity of each entity (i.e., how does the activity of one differ from that of the other; is the activity of each entity continuous from year to year?);
- f. in case of limited liability companies, the extent to which individual partners participate in the management and regular activities of the company;
- g. the amount of capital invested in each entity; and
- h. the economic justification for separate organization.

The allocation of income is made after an investigation shows that:

- a. there is little or no justification economically for separate organization and that capital was also available without separate organization, the risks of each organization are similar, business activities are similar, markets and sources of raw materials are the same, etc., for this and the parent organization;
- b. the control and direction of one organization is identical to that of the others;
- c. the management is the same, or overlaps, or follows the same policies;
- d. in the case of a limited liability company, one individual (or entity) dominates, and other partners are silent, inactive, or without power in the affairs of the company.

- 41.3 Where a domestic corporation is a subsidiary of a foreign corporation and is, in effect, a permanent establishment of that foreign corporation selling its products in Afghanistan, the Ministry may allocate a part of the profits of the foreign corporation to the domestic corporation for taxation.

Example: *A domestic corporation sells manufactured products of the foreign corporation which controls and directs its operations. The domestic corporation shows a net profit of Afs. 1,000,000, and pays a tax of Afs. 200,000. Investigation shows that most of its sales were products of the foreign corporation. Investigation furthermore proves that purchases were not "arms length" at competitive prices when made from the foreign*

corporation. Therefore, the Ministry of Finance can allocate a part of the profit of the foreign corporation to the domestic corporation and assess the domestic corporation on this additional income. Thus, if sales by the foreign corporation to its subsidiary (domestic corporation) were Afs. 40,000,000 in the taxable year, and the world-wide profits of the foreign corporation were six percent of sales, the domestic corporation could reasonably be assessed on an additional Afs. 2,400,000 of taxable income (Afs. 40,000,000 x 6% = Afs. 2,400,000). An additional tax of Afs. 480,000 (Afs. 2,400,000 x 20%) would be due to the State.

Remark: Where a transaction between connected persons results in an amount paid or payable that is different to the amount paid or payable had the transaction been between unconnected persons, Article 102 allows the Ministry of Finance to adjust the amount paid or payable between the connected persons. Reference should be made to the procedures discussed at Article 102 in this Manual.

CHAPTER VI

SPECIAL PROVISIONS RELATING TO CORPORATIONS AND LIMITED LIABILITY COMPANIES

Article 42 – Article 47

Deduction of Operating Loss

- Article 42. (1) A corporation or limited liability company incurring a net operating loss in a taxable year shall be entitled to deduct this loss from its taxable income of three succeeding years, deducting each year one-third of the loss. Paragraph 4 of Article 47 of this Law is an exception to this provision.
- (2) Where a resident company carries on activities that are intended to generate income from a source outside of Afghanistan, the company shall determine its taxable income as defined in Article 12 of this Law or its net operating loss as defined in paragraph (1) of this Article separately in respect of the activities that are intended to generate income from a source in Afghanistan and its activities that are intended to generate income from a source outside of Afghanistan. A net operating loss from activities that are intended to generate income from a source outside of Afghanistan may only be carried forward and deducted from taxable income from such activities and may not be deducted from taxable income from a source in Afghanistan.

- 42.1 A loss must be taken in the year of its occurrence. The happening of some definite event will establish this date for determining the loss.

Example: A corporation incurred a net operating loss of Afs. 120,000 in 1385. As provided by Article 42(1) of the Income Tax Law, this loss may be deducted from the taxable income of the company in three successive years. One-third of the loss may be deducted in each of the three years. This loss is deductible Afs. 40,000 in 1386, Afs. 40,000 in 1387, and Afs. 40,000 in 1388. But in none of these three years may any of these amounts be made to appear as part of a loss of that year. Thus, if in 1386 the corporation had no profit, there could be no deduction of the Afs. 40,000 allowed to be carried forward. If no taxable profit was made in the three succeeding years (1386, 1387, and 1388) none of the Afs. 120,000 loss could be deducted. If no profit was made in 1386 and 1387 but a large profit was made in 1388, the most that could be deducted in 1388 would be Afs. 40,000 in 1388. The amounts that could have been claimed as deductions in 1386 and 1387 will be lost.

- 42.2 A taxpayer may generate losses in successive years. In this case, the losses to be carried forward will overlap. To the extent that they overlap, they may be added to one another.

Example 1: A corporation had the following losses:

<u>Year of Loss</u>	<u>Total Loss</u>	<u>Years of Carry-Over Losses</u>				
		<u>1385</u>	<u>1386</u>	<u>1387</u>	<u>1388</u>	<u>1389</u>
Loss 1384	120,000	40,000	40,000	40,000	None	None
Loss 1385	150,000	None	50,000	50,000	50,000	None
Loss 1386	600,000	<u>None</u>	<u>None</u>	<u>200,000</u>	<u>200,000</u>	<u>200,000</u>
Maximum Loss						
Allowable in Each Year		40,000	90,000	290,000	250,000	200,000

The taxpayer in Example 1 is permitted to add the losses in 1386, 1387 and 1388 to determine the amount of loss that may be deducted against profits in that year.

Example 2: Assume that the corporation in Example 1 has profit of Afs. 2,500,000 in 1388. Since the year 1388 is four years after the year 1384, the carry-over loss of 1384 cannot be deducted from the profit of the year 1388. The maximum carry-over loss allowable is Afs. 250,000.

Remark: Even though only Afs. 50,000 of the 1385 loss of Afs. 150,000 has been claimed as a deduction, the remaining Afs. 100,000 cannot be recovered. The Law does not allow any loss to be carried forward for more than three years from the year of the loss.

Example 3: Assume that the corporation from Example 1 has a loss of Afs. 400,000 in 1389. Even though the 1386 carry forward loss of Afs. 200,000 is not utilized in 1389, it cannot be recovered or offset in any other year. Even if there is a profit in 1390, any remaining balance of the 1386 loss not previously deducted may not be applied since 1390 is the fourth year after the 1386 loss.

- 42.3 A non-Afghan source loss cannot be used to offset or reduce Afghan source taxable income. An Afghan source loss cannot be used to offset or reduce non-Afghan source taxable income.

Example 1: An Afghan corporation operates a carpet store in Afghanistan and Pakistan. The Afghan store is located in Jalalabad. The Pakistani store is located in Lahore. The Afghan corporation purchases carpets that are manufactured in Afghanistan and then sells them to customers in Afghanistan and Pakistan through the two stores. During 1386, the store in Jalalabad generates taxable income of Afs. 1,000,000. The store in Lahore generates losses of Afs. 900,000. The Afghan corporation must pay income tax of Afs. 200,000 (20% x Afs. 1,000,000). The Afghan corporation will not be entitled to deduct its Afs. 900,000 of losses from the store in Lahore against its profits from the sales through the Jalalabad store.

Example 2: *The facts are the same as in Example 1. In 1387, the Afghan corporation's Jalalabad store generates a loss of Afs. 700,000 and the Lahore store generates a profit of Afs. 800,000. The Lahore store's profits are subject to Afs. 320,000 of Pakistani tax. The 1386 loss from the Lahore store may be carried forward and offset against the profits from the Lahore store in 1387. The net profit, after the loss is carried forward is Afs. 500,000. Under Article 5 of this Income Tax Law, the Afghan corporation is entitled to claim a foreign tax credit for the Pakistani taxes that are paid, subject to a limit. The limit equals the amount of the Afghan tax that would be due on the Afs. 500,000 income that was generated in Pakistan, or Afs. 100,000. The excess of the Afs. 320,000 Pakistani taxes over the Afs. 100,000 that can be claimed as a credit, cannot be carried forward and used in future years.*

Distribution of assets to shareholders

Article 43 Except payments of dividends, and except when made in connection with liquidation of a corporation or a limited liability company, the distribution of the assets of the corporation or limited liability company to its shareholders or partners shall be treated by the shareholder or partner as a reduction in the cost of his stock or capital share.

43.1 A distribution of assets of a corporation or limited liability company shall be deemed to be a payment of dividends unless the taxpayer can establish that the company did not have any accumulated earnings or surplus during the tax year in which the distribution was distributed.

Example 1: Adib is an Afghan resident that owns all of the issued stock of an Afghan corporation. The corporation began operations in 1384. During 1385, the corporation distributes Afs. 100,000 to Adib with respect to Adib's stock. The Afs. 100,000 is deemed to be a taxable dividend to Adib unless Adib can demonstrate using the corporation's books and records that the corporation has not generated profit during 1384 and 1385.

Example 2: Adib is an Afghan resident that owns all of the issued stock of an Afghan corporation. The first year of operation is 1385. The Afghan corporation does not generate any profits in the months of Hamal and Saur. On the last day of Saur, the corporation distributes Afs. 10,000 to Adib. During the remaining months of 1385, the corporation generates Afs. 1,000,000 of profit. The Afs. 10,000 distribution to Adib is considered a dividend. Although the corporation did not have any earnings on the date that the distribution was made, the corporation generated earnings during the year in which the distribution was made that exceeded the distribution.

Example 3: Adib is an Afghan resident that owns all of the issued stock of an Afghan corporation. The first year of operation is 1385. The Afghan corporation does not generate any profits during 1385. On the last day of Saur, the corporation distributes Afs. 10,000 to Adib. The corporation generates Afs. 1,000,000 profit in 1386. The distribution of the Afs. 10,000 to Adib in 1385 is not considered a dividend. Although the corporation generated earnings in the year after the dividend, ie 1386, those earnings are not considered in determining whether or not the distribution in 1385 is a dividend.

43.2 The value of the property distributed is its fair market value.

Example 1: Adib owns all of the issued stock of an Afghan corporation. The Afghan corporation has Afs. 1,000,000 of accumulated earnings. Adib causes the Afghan corporation to distribute equipment to him. The equipment has a cost basis of Afs. 100,000, but is worth Afs. 150,000.

The distribution of the equipment is considered a dividend of Afs. 150,000 to Adib. Adib takes the equipment with a cost basis of Afs. 150,000.

Example 2: *Adib owns all of the issued stock of an Afghan corporation. The Afghan corporation has no accumulated earnings. Adib invested Afs. 200,000 in the stock of the Afghan corporation. Adib causes the Afghan corporation to distribute equipment to him. The equipment has a cost basis of Afs. 100,000, but is worth Afs. 150,000. The distribution of the equipment is considered a return of Afs. 150,000 investment capital to Adib. Adib takes the equipment with a cost basis of Afs. 150,000.*

- 43.3 A distribution of assets to shareholders reduces (but not below zero) the cost of shares owned by each shareholder by an amount equal to the distribution received. Such receipt is not taxable income of the shareholder because it is a return of capital he invested at the time he purchased his shares. A record of this return (refund) of capital must be kept to show the reduced cost to the shareholders of his shares. If the shareholder subsequently transfers his shares, the reduced cost will determine gain or loss from such transfer. If the value of a distribution exceeds the shareholder's cost basis in the shares, then the shareholder will realise a gain with respect to the distribution equal to the amount of the excess.

Distribution of assets at the time of liquidation of company

Article 44 A distribution of assets among shareholders or partners in connection with liquidation of a corporation or a limited liability company shall be treated by the shareholder or partner as proceeds from sale or exchange of assets as provided in Chapter III of this Law. The amount distributed in money plus the market value of any other assets distributed less the shareholder's cost of the stock or the amount of partner's capital on which distribution is made is taxable income of the shareholder or partner. No gain or loss shall be recognized to the corporation or limited liability company on the distribution of its assets in partial or total liquidation.

44.1 A liquidating distribution by a corporation to its shareholders is considered first a return of earnings and then a return of invested capital. To the extent the distribution is a return to the shareholder of capital invested by him, it is not income. To the extent the distribution exceeds the shareholder's invested capital, the distribution gives rise to a taxable gain to the shareholder.

Example: *Adib owns all of the issued stock of an Afghan corporation. Adib purchased the stock in a prior year for Afs. 1,000,000. After selling all of its assets, the corporation has Afs. 500,000 of earnings and Afs. 2,000,000 of cash. Adib causes the corporation to liquidate, distributing all of its cash to Adib. Adib recognizes Afs. 500,000 as a taxable dividend. The next Afs. 1,000,000 is considered a return of capital that is not income to Adib. The remaining Afs. 500,000 of the distribution is considered a taxable gain to Adib, because it exceeds Adib's cost basis in his shares of stock.*

Distribution of money or other assets

Article 45 A dividend is any distribution of money or assets made by a corporation or a limited liability company to its shareholders or partners out of earnings. Dividends are subject to the following provisions:

1. Dividends paid in cash by a corporation or limited liability company which is organized under the laws of Afghanistan are deductible from the income of the company which makes the payment except where paragraph 2(2) of Article 18 applies.
2. Dividends paid in the form of securities of any kind are not deductible from income of the corporation or limited liability company.
3. Dividends paid in money are taxable income of the recipient at the time received, but dividends in the form of securities of any kind are not considered taxable income of the recipient at the time received.

45.1 If a corporation or limited liability company makes dividend payments that are non-deductible under Article 18(2)2 because withholding tax has not been paid, the payments will continue to be treated as “dividends” under this Law. Shareholders will be liable to income tax on the dividends received.

45.2 A corporation or limited liability company may not deduct the value of its securities that it issues in the form of dividends.

Example 1: Adib and Wahid each own 50 shares of the issued stock of an Afghan corporation. The corporation has 100 shares issued. The corporation has Afs. 1,000,000 of accumulated profits. The corporation issues an extra share of its stock to Adib and Wahid. Each share is worth Afs. 9,000. The corporation cannot deduct any amount.

Example 2: Adib and Wahid each own 50 shares of the issued stock of an Afghan corporation. The corporation has 100 shares issued. The corporation has Afs. 1,000,000 accumulated earnings. The corporation distributes a promissory note to each of Adib and Wahid. The promissory notes each have a principal amount of Afs. 10,000. The corporation cannot deduct the value of the notes from its taxable income.

Example 3: Adib and Wahid each own 50 shares of the issued stock of an Afghan corporation called Company A. Company A has 100 shares issued. Company A has Afs. 1,000,000 accumulated earnings. Company A owns 200 shares of another corporation called Company B. Company A distributes the 200 shares of Company B stock to Adib and Wahid. Each share of Company B stock is worth Afs. 10. Company A can deduct the value of the Company B shares that it distributes from its taxable income. The Company B shares are treated just like any other item of property.

Example 4: Adib and Wahid each own 50 shares of the issued stock of an Afghan corporation called Company A. Company A has 100 shares issued. Company A has Afs. 1,000,000 accumulated earnings. Company A owns notes that were issued by another corporation called Company B. The notes have a value of Afs. 200,000. Company A distributes the Afs. 200,000 notes to Adib and Wahid. Company A can deduct the value of the Company B notes that it distributes from its taxable income. The Company B notes are treated just like any other item of property.

- 45.3 If securities are received as dividends they are not considered taxable income in the year they are received. The proceeds of the sale, exchange, repayment or transfer of such securities are, however, taxable income. In this case, because the recipient did not pay anything for these securities the entire proceeds are considered taxable gain. The expense of sale may be deducted.

Example 1: In 1384 a shareholder receives stock dividends in the form of ten shares. In 1385 the shareholder sells his ten shares for Afs. 6,000. He had no expense in selling these shares and therefore the entire Afs. 6,000 is income subject to taxation in 1385.

Example 2: In 1384 a shareholder of a corporation receives notes issued by that corporation. The notes have a face value of Afs. 100,000. The shareholder does not have to include the notes in his income when they are received. The notes have a cost basis to the shareholder of zero. If the corporation makes a Afs. 10,000 payment on the notes, the payment is considered income to the shareholder at that time. The shareholder has to include the Afs. 10,000 payment in his income. The shareholder is entitled to increase its basis in the notes by Afs. 10,000. The corporation is entitled to deduct the Afs. 10,000 payment as if it were a dividend.

Withholding Tax

- Article 46. (1) A profit or non-profit legal person organized under the laws of Afghanistan is required to withhold income tax as follows:
1. in the case of wages and salaries, in accordance with the provisions of this Law;
 2. 20%, in the case of interest, dividends, royalties, or similar income subject to provisions of in this Law
- (2) Tax withheld under this Article is to be paid to the State no later than 10 days after the end of the month in which the tax was withheld.
- (3) No later than the last day of Hamal, a legal person making payments subject to withholding tax under the provisions of the Law shall provide each person receiving amounts that have been subject to withholding tax with details of payments and withholding tax in the manner prescribed by the Ministry of Finance.
- (4) No later than 10 days after the end of each month, a person making payments subject to withholding tax shall provide details of payments and withholding tax to the Ministry of Finance in the manner prescribed by the Ministry of Finance.
- (5) Where the correct amount of tax has been withheld from an amount in accordance with the provisions of this Law, it is deemed that the income tax on this amount has been fully satisfied.
- (6) A natural person who has income from more than one source is required to file a tax return and income tax shall be computed based on provisions of this Law. Any amount of tax which has been withheld on payment of the income will be allowed as a credit deductible against income tax otherwise payable.

46.1 By dividend paid in money is meant the sum or the following two items:

- a. The dividend in money paid to the shareholder, plus
- b. The tax withheld and paid to the State.

Thus, when paying dividend in money, 80 percent is paid to the shareholder and 20 percent to the State.

46.2 A corporation that makes a dividend distribution to its shareholder must issue a statement. The statement issued to the shareholder with his dividend shall be prepared in triplicate. The three copies shall be distributed and used as follows:

- Two copies shall be issued to the shareholder. The shareholder shall attach the original to his income tax return to get credit for the tax withheld and retain one copy.
- The third copy shall be attached to the report filed with the bank at the time the taxes withheld are remitted by the company.

46.3 The tax withheld on a dividend, though remitted by the corporation, is a tax on earnings of shareholders. The tax withheld may be credited by the shareholder against his total income tax liability including the dividend received plus tax withheld. In order to receive credit for overpayment of tax due to tax withheld, the taxpayer must file an income tax return.

Example: Consider the following case:

a.	A shareholder has taxable income of	Afs. 500,000
b.	In addition, he receives cash in amount of Afs. 100,000 which resulted from a dividend of Afs. 125,000 from which 20%, or Afs. 25,000, has been withheld	Afs. 125,000
c.	Total taxable income	Afs. 625,000
d.	Income tax based on the rate schedule of Article 4 of the Income Tax Law:	
	Tax on Afs. 150,000	Afs. 0
	Tax on Afs. 475,000	Afs. 47,500
e.	Deduct taxes withheld	- Afs. 5,000
f.	Tax Due	Afs. 22,500

46.4 The taxes withheld from dividends shall be paid to the State within 10 days after the end of the month in which the tax was withheld. The entire dividend declared by the company must be paid, with the State receiving the amount withheld and the shareholders receiving the balance.

Example: A company subject to tax withholding from dividends declares a dividend of Afs. 100 per share on its 50,000 shares of stock, or a total dividend of Afs. 5,000,000 which is reportable as income by the shareholders. Of this amount, Afs. 4,000,000 (80 percent of 5,000,000) will be paid to the shareholders and Afs. 1,000,000 (20 percent of Afs. 5,000,000) will be withheld for taxes. The amount withheld must be paid to the State within ten days after the end of the month when the tax was withheld.

Remark: Taxes withheld from wages and salaries, interest and royalties shall similarly be paid to the State within 10 days after the end of the month in which the tax was withheld.

46.5 At the same time as the taxes withheld from dividends are paid to the State the company shall file with the tax office a report listing the names of all shareholders, the amount of dividend withheld and the amount paid each

shareholder or partner. This report shall be made on the prescribed form. (For prescribed forms, refer to the Appendix to this manual.)

Deduction of Depreciation and Losses

- Article 47. (1) From 21 June 2004 and as an exception to paragraph 1 (7) of Article 18 of this Law, an approved enterprise registered under the Law on Domestic and Foreign Private Investment in Afghanistan shall be entitled to a deduction for the depreciation of capital assets as follows:
- four years for buildings; and
 - two years for other capital assets.
- (2) The depreciation deduction for buildings and other capital assets shall be an equal deduction for each fiscal year of depreciation. If a capital asset is owned by the enterprise for less than one half of the year, a deduction for half the annual amount will be allowed in that year.
- (3) The depreciation deduction shall only apply to capital assets acquired and first used in the year in which the enterprise became an approved enterprise or registered enterprise (whichever is earlier) or in the following two years.
- (4) From 21 June 2004 and as an exception to Article 42 of this Law, an approved enterprise that incurs a net operating loss in a fiscal year based on legal records and accounting records may carry this loss forward as a deduction from taxable income in each subsequent year until the loss is fully extinguished. The loss incurred by such approved enterprise shall be calculated in accordance with Article 42 of this Law. Depreciation and expenditure which relate to a period covered by a tax exemption or to a period before an enterprise first became an approved enterprise cannot be used in the calculation of a net operating loss.

- 47.1 Taxpayers must use the “straight line” convention in computing their depreciation deductions under this Article. Under the “straight line” method of depreciation, an equal amount of depreciation is taken each year.

Example: *An Afghan corporation purchases equipment for Afs. 10,000,000 at the beginning of 1385. The corporation is entitled to claim Afs. 5,000,000 of depreciation in 1385 and Afs. 5,000,000 depreciation in 1386.*

- 47.2 A taxpayer that owns property at any time during the year may claim a depreciation deduction for that property in that year. If, however, the taxpayer owns the property for less than one half of the year the taxpayer will be entitled to claim one-half of the annual depreciation for that property in that year. If, as a result of this rule, the taxpayer has not fully depreciated the property in the two (2) fiscal year or four (4) fiscal year period, then the remaining depreciation shall be claimed in the immediately succeeding year.

Example: *An Afghan corporation purchases equipment for Afs. 10,000,000 in the last month in 1386. The corporation continues to hold the property throughout 1387 and 1388. The corporation can claim the following deductions in the following years:*

	<u>Deduction</u>
<i>Year 1386</i>	<i>Afs. 2,500,000</i>
<i>Year 1387</i>	<i>Afs. 5,000,000</i>
<i>Year 1388</i>	<i>Afs. 2,500,000</i>

Remark: For further information on the interpretation and application of this Article, reference should be made to the Ministry of Finance Public Ruling titled 'Tax Holidays, Exemptions and Concessions for Investment'.

CHAPTER VII

TAXATION OF INSURANCE COMPANIES

Article 48 – Article 53

Provisions for applicable insurance companies

- Article 48. The Articles of this Chapter apply to an insurance company provided it meets the following conditions:
1. It shall have been organized as a corporation under the laws of Afghanistan.
 2. The company is engaged in more than one field of insurance, such as casualty-risk insurance, life insurance, or in any other type of insurance activity.
 3. The company must have separate accounting and reserves for each of its fields of insurance and other activities.

48.1 Insurance companies require large reserves to pay claims made by their policy holders. Chapter VII of the Income Tax Law allows insurance companies to use receipts for creating such reserves and, in turn, requires separate accounting for each field of insurance with basically different reserve requirements.

- a. One field of insurance is "insurance against fire, theft, accident, sickness, casualty, or risk of any kind in which insurance is for a specified term."

Ordinarily, claims for losses suffered by policy holders will equal premiums received, plus expense and profit. However, in some years of unusual combinations of disasters, ample reserves will be necessary if the company is to pay all losses. For this field of insurance, reserves (for claims) equal 100 percent of premiums for transport insurance plus 50 per cent of premiums for other risk insurance received in the year are allowed.

Example: If premium income for transport insurance in 1385 is Afs. 1,000,000, and premium income for other risk insurance in 1385 is Afs. 10,000,000, the company is allowed to transfer its profits to this reserve until the reserve is Afs. 6,000,000 - that is, Afs. 1,000,000 for transport insurance plus Afs. 5,000,000. for other risk insurance.

In addition to this reserve, a reserve for losses equal to twice the paid in capital is allowed. In any year at the beginning of which both these reserves are at their maximum and the premium income is not increased, no income-tax-free transfer to reserves can be allowed.

Thus, based on the facts in the foregoing example, the following reserves would be permissible:

Insurance	Premium Income	Reserve Allowed	Reserve Allowed
Transport	1,000,000	100% 1,000,000	200% of the paid
Other	10,000,000	50% 5,000,000	up capital

- b. The other field of insurance is “written contracts that require ultimate payment of specified benefits to the policy-holder or his beneficiaries.” Ordinary and paid-up life insurance, endowment plans, annuity contracts, and other savings plans which may be offered by insurance companies are examples of this kind of insurance. Accumulation of reserves that will meet the ultimate payments specified in policies is necessary. The purchaser of an annuity expects to get his money plus interest back in the form of monthly income at some future specified date. The insurance company must invest all of this premium income to meet this contractual obligation. Similarly, as life insurance will be paid eventually upon the death of the insured, premiums must be accumulated so that this obligation which cannot be avoided unilaterally by the company can be paid and so an entirely different basis for building reserves is permitted for this field of insurance. All premium income is exempt (just as bank deposits are not subject to tax). Since premium income is exempt, expenses that are ordinarily paid directly out of premium income are not deductible. Nor are benefits (claims) paid to policy-holders deductible, for the simple reason that they are paid out of reserves built by “income-tax-free” premium income. This distinction between reserves for the two fields of insurance must be clearly understood and accounting must be completely separated. Otherwise, taxable income cannot be determined accurately.

*Example: An insurance company with a paid-in capital of Afs. 500,000 writes transport and other risk insurance exclusively. In 1386 it began the year with a reserve for claims of Afs. 2,000,000 and for losses (in operations) of Afs. 1,000,000. During 1386 its premium income is Afs. 400,000 for transport insurance and Afs. 4,100,000 for other risk (loss and accident) insurance. Its net profit is Afs. 540,000 **before** any additions to reserves have been made.*

This company can increase its reserves as follows:

- a. Reserves permissible at end of year:**

1. For losses: Afs. 500,000 x 2	Afs. 1,000,000
2. For claims: Afs. 400,000 (transport) x 100%	400,000
Afs. 4,100,000 (other risk) x 50%	<u>2,050,000</u>
Total Reserves permissible at the end of year	Afs. 3,450,000

** Remark: The company may add to its reserve any amount available. If, however, the reserve is increased to more than the permissible amounts, the excess added may not be deducted in computing taxable income.*

- b. The company began the year with Afs. 3,000,000 of reserves. Hence, only Afs. 450,000 can be deducted.*

This amount if added to reserves in 1386 may be deducted from the net profit of Afs. 540,000, leaving a taxable income of Afs. 90,000 (that is, the difference between Afs. 540,000 and Afs. 450,000).

- 48.2 An insurance company engaged in more than one field of insurance as described in Regulation 48.1 must maintain separate accounting for each field of insurance. That means that premium income, expenses, reserves set up, income from investment of reserves, etc., must be recorded in separate accounts for each field of insurance. Some administrative expenses may be allocated but only on a consistent and reasonable basis. Thus, premiums for risk insurance, commissions paid for writing risk insurance, risk insurance claims paid, reserves for claim of risk insured, income from such reserves, paid-in capital allocated to risk insurance, etc., must be recorded in a distinct and separate set of accounts, and must not be intermingled with similar income and disbursements, reserves, and capital belonging to other fields of insurance.

In this way, the profit or loss from each field of insurance can be determined. The reserve for each field of insurance will be increased exclusively from its own receipts or profit. Separate profit and loss statements and balance sheets must be prepared for each field of insurance and must be submitted to the Ministry of Finance. Taxable income of the company will, however, be determined on the basis of the total business of the company.

Example: *A company engaged in both risk insurance and life and annuity insurance keeps completely separate accounting and reserves for both fields of insurance. In 1386 its net profit from its operations in risk insurance is transferred to reserves for claims which are below the maximums which may be provided income-tax-free.*

If in the same year the company has a net profit of Afs. 250,000 from its life and annuity insurance business, no part of this net profit is deductible from taxable income even though added to lawful reserves. The entire amount is taxable income either of the company if not distributed in dividends or of the shareholders subject to tax withholding.

Taxable Income of Insurance Companies

Article 49. The following receipts of insurance companies are subject to income tax:

1. Interest, dividends, rent, and other income from investments and property;
2. all receipts from activities other than insurance;
3. all premiums for insurance against fire, theft, accident, sickness, casualty, or risk, the insurance of which is for a specified term, and the insured person has no money claim after the term has expired; and
4. income from capital transactions.

49.1 Premiums received for risk insurance are generally included in income and subject to taxation, while premiums for the insurance described in Article 50 of the Income Tax Law are not.

Example: *A company writing risk insurance includes all premiums received and deducts all claims paid, commissions, other expenses of selling insurance, and administrative expenses in determining its net profit.*

A simplified statement of income and expense (operating statement) of this company would appear as follows:

a. Receipts:

1. Premium income	Afs. 2,500,000
2. Less claims paid	- <u>1,600,000</u>
Gross gain (difference of two items above)	Afs. 900,000
3. Other receipts - (interest, dividend, etc.)	<u>75,000</u>
4. Income before expenses	Afs. 975,000

b. Expenses:

1. Fees and commissions of salesmen	300,000
2. Adjusting claims expense	75,000
3. Business receipts tax (2% of premiums)	50,000
4. Other administrative expense	175,000
5. Allowable additions to reserves made	175,000
Total expenses deductible	<u>775,000</u>

c. Net taxable income *Afs. 200,000*

49.2 Group life insurance shall be considered to be risk insurance in either of the following cases:

- a. if premiums are changeable as individuals increase in age or

- b. if individuals leaving the group cannot continue insurance at the same rate as those in the group and in the same age bracket.

Example: *Insurance at a low rate is offered to all employees of a corporation provided at least a given percentage of the employees are insured. Rates are lowest for the youngest employees and highest for the oldest and are set for the age bracket, not the individual. Thus, if the rate is higher for the 41 to 50 age bracket than for the 31 to 40 age bracket, and a person upon reaching 41 must pay a higher premium, the increased risk is reflected in the premium. Also, employees who leave the group are dropped from the group insurance policy but are allowed to become insured under a separate policy at higher rates. Both of these conditions point out that this is term insurance against the risk of death of an employee while a member of the group. Reserve requirements here typify those of the casualty-risk field of insurance. Therefore, premium income from this group insurance is taxable and claims paid are deductible.*

- 49.3 Since all gain from sale or exchange of any capital asset of a corporation or limited liability company is subject to taxation, any gain from the sale or exchange of investments and property owned by insurance companies is likewise subject to taxation.

Exemption of Income from Certain Premiums

Article 50. All insurance premiums received for written contracts that require ultimate payment of specified benefits to the policyholder or his beneficiaries are exempt from income tax.

50.1. Although ordinary and paid-up life insurance, endowment plans, annuity contracts, and various combinations of life insurance with savings plans are insurance for which premiums received by the insurance company are exempt from taxation, each kind of insurance policy issued should be examined before it is so classified. Premiums are exempt only if the insurance policy meets the following tests:

- a. The policy cannot be terminated by the insurance company without payment of benefits or except upon failure of policyholder to pay the premiums as provided in the policy;
- b. The insurance premiums specified in a policy cannot be increased by the insurance company;
- c. The policy remains in effect regardless of whether or not the insured continues to be a member of any particular group, occupation, etc,
- d. The premiums for the insurance are added to the reserve for policyholders and invested. Only specified sales commissions and the business receipts tax on premiums may be paid out of the premiums received;
- e. The reserve for policyholder shall also be supported by income from investments of funds from a lawful reserve;
- f. No transfers out of the reserve for policyholders are permitted except in payment of benefits to policyholders or their beneficiaries.

Non-deductible expenses of insurance companies

Article 51. The following expenses and payments made in connection with insurance for which premium income is tax exempt under Article 50 are not deductible:

1. Commission expense and other costs of writing insurance; and
2. Payments of benefits to the policyholders or their beneficiaries.

51.1 Commission expense and other costs of writing insurance for which premiums are exempt from taxation, and payments of benefits of such insurance are not deductible expenses. They are paid either out of premium receipts (in the case of sales commissions) or out of tax-free reserves.

Although premium income is exempt and the above expenses and disbursements are not deductible, the insurance company must include complete information about these items and the reserves in its reports to the Ministry of Finance.

Example: A simplified statement covering the reserve and operations would appear as follows:

Statement on Policyholder's Reserve:

a.	Reserves at beginning of year	Afs. 10,000,000
b.	Addition to reserves during year:	
	1. premiums received during year	Afs. 2,000,000
	2. expenses:	
	commissions paid	Afs. 100,000
	business receipts tax	<u>40,000</u>
	total expenses	140,000
	Added to reserve during year (2,000,000 — 140,000)	1,860,000
c.	Sum of items (a) and (b).	11,860,000
d.	Claims and benefits paid during year	1,500,000
e.	Difference of items (c) and (d).	10,360,000
f.	*Additions to reserve from investment income	260,000
g.	Reserve at end of year	Afs. 10,620,000

*Remark: This reserve addition is made after taxes on income.

Income and Expense Statement:

a.	Income subject to taxation, including:		
	Interest, dividends, capital gains during year	Afs.	600,000
b.	Deductible expenses:		
	1. Business receipts tax	Afs.	30,000
	2. Administrative expenses		200,000
	Total deductible expenses		<u>230,000</u>
c.	Taxable income (difference between (a) and (b)).	Afs.	<u>370,000</u>

Deductible expenses of insurance companies

- Article 52. (1) The following expenses and payments of insurance companies are deductible from their income:
1. claims paid on insurance for which premium income is taxable;
 2. commissions and other costs of writing insurance for which premium income is taxable;
 3. reinsurance costs of insurance for which premium income is taxable;
 4. additions to reserves for compensation of claims, provided such reserves do not exceed 100 per cent of premiums for transport insurance and 50 per cent of premiums for any other risk insurance received during the taxable year;
 5. additions to reserves for losses in operations in the field of insurance for which premium income is taxable, provided such reserves do not exceed twice the amount of invested capital for such field of insurance;
 6. all necessary expenses of doing business as provided in Chapter II of this Law except those cited in Article 51.
- (2) Any transfers or payments from reserves referred to in sub-paragraphs (4) and (5) of paragraph 1 of this Article, except for actual claims and losses or for dividend payments in money, are taxable income in the taxable year during which the transfer or payment was made.

52.1 All receipts of insurance companies are subject to business receipts taxes as provided in Chapter X of the Income Tax Law. "Insurance for which premium income is taxable" refers only to casualty-risk insurance. It will be noted that receipts and expenditures of casualty-risk insurance are treated the same as in other lines of business. Thus, all receipts including premiums are subject to income tax and all disbursements, including claims paid, that are legitimate and necessary expenses of business are deductible in computing taxable income. The significant provision of Chapter VII with respect to casualty-risk insurance is deductibility of additions to reserves is provided in paragraphs 4 and 5 of Article 52(1).

52.2 Though additions to reserves described in paragraphs 4 and 5 of Article 52(1) of the Income Tax Law are deductible, any transfers out of these reserves for purposes other than payment of claims and losses are subject to income tax. If dividends are paid to shareholders, taxes must be withheld and remitted to the State in accordance with Article 46 of the Income Tax Law. If funds are used for purposes other than prudent investments which have reasonable

liquidity, such uses shall also be deemed transfers out of the reserves subject to income tax.

In the absence of law governing the investment of insurance company reserves, the Ministry of Finance will have to consider the purpose of the reserve and the nature of each investment of reserve funds. Reserves against claims and losses of casualty-risk insurance need to be reasonably "liquid" if unexpected and unusual losses are to be covered (which is the purpose of these reserves). Therefore, salability or convertibility of the investment to money within a period of time reasonable from the viewpoint of time allowable in fair settlement of claims should guide the Ministry in determination of the status of an investment. If the investment meets the requirement of liquidity it does not constitute a transfer from the reserve, but if it does not meet this requirement it is deemed a transfer from the reserve and taxed.

Example: *A casualty-risk insurance company erects an office building to house its own office and other offices and shops to be leased. A substantial part of the funds in the reserve for claims is invested in this property. The remaining cost is borne by a mortgage loan from an investment bank. The mortgage loan is approximately the maximum that can be borrowed on this office building. Therefore, the funds used in completing this investment must be deemed a transfer from the reserve subject to tax. This investment in the building on "top" of the mortgage is highly "nonliquid," and cannot serve the purposes of the reserve. If on the other hand, the entire cost of the property had been paid with funds from the reserve for claims, and the insurance company can furnish a mortgage loan commitment from an investment bank, the amount of the commitment may be deemed to meet the requirement of the reserve, and only the difference between the total cost and the commitment would be deemed to have been transferred and, therefore, taxable.*

- 52.3 The reserve for policyholders' claims and benefits built from exempt premiums described in Article 50 of the Income Tax Law is ordinarily supported by premiums and income from investment of funds in the reserve. Although the law does not allow deduction of additions out of investment income to this reserve without payment of tax, the premium income going into this reserve is tax-free (exempt) income. The reason for this difference is that since the benefits received by the policyholders or their beneficiaries are not subject to income tax, such benefits have, theoretically, been bought and paid for by the policyholder. Since part of these benefits originated from investment income there is, however, an element of income in such benefits, and taxing the recipient directly is obviously impracticable. Therefore, the insurance company is taxed on investment income added to this reserve and subsequently transferred to the recipient. As a result, the recipient is taxed indirectly on any part of benefits arising out of investment income.

Determination of taxable income of foreign insurance companies

Article 53. Any foreign insurance company or underwriter receiving premium income of any kind from within Afghanistan is subject to income tax as follows:

1. the premiums received by the company from within Afghanistan in the taxable year shall be determined;
2. the total premiums received world-wide by the company in the same period shall be determined;
3. the net income amount before income tax and dividend payments of such company from its world-wide business shall be determined;
4. the amount determined in sub-paragraph (1) divided by the amount determined in sub-paragraph (2) multiplied by the amount determined in sub-paragraph (3) shall be taxable income.

53.1 Premiums paid by a natural person who is an Afghan resident or a legal person created under the laws of Afghanistan to a foreign insurance company are considered income from sources within Afghanistan and are subject to income tax. This includes reinsurance premiums paid by a domestic insurance company to a foreign insurance company. Taxable income of a foreign company from sources within Afghanistan is determined as follows:

- a. The total world-wide premium income, which is the total of all premium income received by the foreign company from all countries during the relevant fiscal year, is determined.
- b. The total gross receipts of the foreign company from all sources is determined.
- c. The total of disbursements paid to policyholders is determined.
- d. The increase in reserves for policyholders is determined. (By "increase in reserves" is meant the net increase in the reserve from the beginning of the year to the end of the year.)
- e. The total of necessary expenses of doing business, (except income taxes, dividends paid to shareholders, and addition to reserves), is determined.
- f. The amounts determined in (c), (d), and (e) are totaled.
- g. The worldwide net income of the foreign company from all countries is determined by subtracting the total obtained in (f) from the total receipts from all sources in all countries during the latest fiscal year, obtained in (b).

- h. The total of the premium income from Afghanistan in the relevant fiscal year is determined.
- i. The world-wide net income of the foreign company from all countries (g) is divided by the total of the world-wide premium income of the foreign company from all countries (a).

The above quotient shows the average ratio of premium income from all countries that is net income.

- j. The total premium income from Afghanistan is multiplied by the ratio found in (i) above.

The product so obtained is taxable income from sources within Afghanistan and is taxed at the rate of 20 per cent.

Remark: It should be remembered that no deductions are allowed from the taxable income computed in (j) above, as the formula itself provides all deductions on an average basis.

Example: *An agency of a foreign insurance company in Afghanistan remits premiums amounting to Afs. 600,000 to the account of the foreign company in 1384. Taxable income of the foreign company from sources within Afghanistan is computed as follows:*

- a. *The total world-wide premium income of the foreign company in the year 2005 (the period which corresponds to 1384) is found to be US\$25,000,000;*
- b. *The total gross receipts of the foreign company from all sources is determined to be US\$30,000,000.*
- c. *The total of disbursements paid to policyholders (such as claims and benefits) is found to be US\$19,000,000.*
- d. *The increase in reserves for policyholders is found to be US\$7,000,000.*
- e. *The total of necessary expenses of doing business is determined to be US\$1,500,000.*
- f. *The total of figures from (c), (d), and (e) is determined:*

	US \$19,000,000	(c)
	7,000,000	(d)
	<u>1,500,000</u>	(e)
Total	US \$27,500,000	

- g. *The world-wide net income of the foreign company from all countries is determined. For this purpose, the total figure obtained in (f), that is, \$27,500,000, should be subtracted from the figure in (b).*

Namely:

$$\text{US\$30,000,000} - \text{US\$27,500,000} = \text{US\$2,500,000}$$

- h. *The total of the premium income from Afghanistan in 1384 is determined. In this example, the amount is Afs.600,000.*
- i. *The figure obtained from (g) should be divided by the figure in (a):*

$$\text{US\$2,500,000} \div \text{US\$25,000,000} = 1/10$$

Therefore, the average ratio of premium income from all countries to net income is 1/10, that is 1/10 of the premium income from all countries is net income.

- j. *From the computation in (i), it is seen that 1/10 of the premium income from Afghanistan should be considered as net income, and therefore the net taxable income of the foreign company from sources within Afghanistan is:*

$$1/10 \times \text{Afs. 600,000} = \text{Afs. 60,000}$$

The tax to be paid to Afghanistan on Afs. 60,000 net income by the foreign company, would be 20 per cent of Afs. 60,000, or Afs. 12,000.

Remark: *The agency itself is also subject to income taxes on its own profit from the sale of insurance. Both the agency and the foreign insurance company are also subject to the business receipts tax of Chapter X of the Income Tax Law - the agency on its gross commissions and other income, the foreign insurance company on its receipts of premiums.*

CHAPTER VIII

TAXATION OF BANKS, CORPORATIONS, LOAN AND INVESTMENT CORPORATIONS

Article 54 — Article 57

Gains subject to tax

Article 54. Income of banks, loan and investment corporations are subject to income tax on all income from dividends, interest, discounts, rents, service charges, fees, commissions, and on gains from capital transactions.

- 54.1 Deposits and investments received by a bank, loan or investment company are not subject to income tax or the business receipts tax.

Example: During a taxable year a bank receives a total of Afs. 20,000,000 from customers for deposit in savings accounts and/or demand accounts. During the same year the bank earns a total interest income of Afs. 5,000,000 on loans made to borrowers. Here, the Afs. 20,000,000 received is not subject to income tax or the business receipts tax. The Afs. 5,000,000 is subject to both taxes. Taxable income under the Income Tax Law is, however, the amount remaining after deductible expenses have been subtracted from the Afs. 5,000,000.

- 54.2 Interest income from bonds of the State or municipalities of Afghanistan is exempt from income tax under paragraph 13 of Article 14 of the Income Tax Law. This also applies to income from such bonds owned by banks, loan and investment companies.

Example: A commercial bank has interest income of Afs. 5,000,000 during a taxable year. Afs. 400,000 is from bonds of the State which are owned by the commercial bank. This Afs. 400,000 is exempt from the income tax but not from the business receipts tax. The total interest income of Afs. 5,000,000 should be reported as income received, and Afs. 400,000 deducted to determine the taxable income of the bank.

Deduction of necessary expenses

Article 55. Necessary and ordinary business expenses are deductible from the income described in Article 54 of this Law. Losses from capital transactions, dividends paid in money and additions to a reserve against losses on loans are also deductible.

55.1 Withdrawals by depositors or investors from a bank or loan and investment company are not deductible from income. Since the deposits and investments were not income of the bank or company when received, they are not expenditures when returned to the depositors or investors by the bank or loan and investment company.

Example: A bank's statement shows the following record of deposits:

a.	Deposits at beginning of year	Afs. 60,000,000
b.	Deposits during year:	
	1. Deposits received during year	Afs. 20,000,000
	2. Withdrawal during year	<u>15,000,000</u>
	3. Net deposits during the year (difference of items 1 and 2)	<u>5,000,000</u>
c.	Deposits at end of year	Afs. 65,000,000

None of this increase is income or expense. This statement merely shows the bank's liability to depositors. Neither income tax nor the business receipts tax applies here.

55.2 Interest paid to depositors or investors by a bank or investment company is deductible from income of the bank or company. Paragraph 4 of Article 18 of the Income Tax Law provides that "interest on business loans" is deductible. The bank or investment company is in the business of accepting money for deposit and safekeeping and placing such money on loan to borrowers for the purpose of earning interest income. The interest paid by the bank or investment company is a necessary expense of such business, and is an inducement to those with surplus funds to deposit them with the bank or investment company.

Example: During a taxable year a bank earns a total of Afs. 5,000,000 from interest, dividends, and gains realized from its business of loaning and investing funds in its possession. During the same year the bank has paid or owes Afs. 3,500,000 interest to depositors who have placed their money in savings accounts. This amount of Afs. 3,500,000 is deductible from income as are other necessary expenses of doing business.

55.3 By "losses from capital transactions" is meant losses realized at the time of sale of securities owned by the bank or investment company. Loss is the difference between the amount received on the sale of shares, loans, and

capital, etc. and the amount paid for the security by the bank or investment company.

Example: *A bank purchased bonds of the State issued in 1385 at interest of four per cent per year. The bank paid Afs. 1,000 per bond, which was the face value at the time of issue and purchase. The bank carried these bonds on its books at Afs. 1,000 per bond. In 1387 the State issued bonds at interest of 4½ per cent per year. This caused a reduction in market value of four per cent bonds issued in 1385.*

The bank sold 100 of its 1385 bonds in 1387 at a total price of Afs. 90,000. These bonds being carried on the books at Afs. 1,000 each, or Afs. 100,000 for 100 shares, were therefore sold at a loss of Afs. 10,000. This loss is a deductible expense of the bank for taxable year 1387.

Additions to reserves

Article 56. Additions to reserves against losses on loans are deductible only if such reserve does not exceed 25 per cent of loans outstanding at the end of the taxable year. Any transfers or payments from such reserve, except in accordance with the purpose of the reserve, is taxable income in the year the transfer or payment was made.

- 56.1 If, at the end of the taxable year, the reserve for losses on loans exceeds 25 per cent of the loans outstanding, and additions to such reserves have been made during the taxable year, there shall be allowed as deduction for additions to such reserve only the amount necessary to make the reserve 25 per cent of loans outstanding at the end of the year.

Example 1: *In the middle of the year 1385 a bank increased its reserve for losses on loans by Afs. 200,000. By the end of the year its outstanding loans had diminished so that its reserve for losses on loans was more than 25 per cent of loans outstanding. Part of the additions made earlier in that year is therefore not deductible. If the reserve for losses at the beginning of the year 1385 is Afs. 6,000,000, and the loans outstanding at the end of 1385 are Afs. 24,500,000, the following computation shows how deduction is determined:*

a. Reserve for losses at beginning of 1385	Afs. 6,000,000
b. Added to reserve midyear 1385	200,000
c. Reserve at end of 1385	6,200,000
d. Outstanding loans end of 1385	24,500,000
e. 25% of outstanding loans	6,125,000
f. Excess in reserve (Afs. 6,200,000 — Afs. 6,125,000)	75,000
g. Amount of 1385 additions which were deductible (Afs. 200,000 — Afs. 75,000)	Afs. 125,000

Therefore, only Afs.125,000 may be allowed as a deduction in computing taxable income, though Afs.200,000 was added to the reserve during the taxable year.

Example 2: *If the same bank had the same beginning reserve, addition to reserve, and ending reserve, but had loans outstanding at end of year of Afs. 24,000,000 or less, none of the Afs. 200,000 addition made at midyear would be deductible. This is true because the allowable reserve (25 per cent) on loans outstanding (Afs. 24,000,000) is Afs. 6,000,000, the amount which was already in the reserve before the addition was made.*

- 56.2 If a reserve for losses on loans exceeds the reserve required by law, the bank or investment company might transfer excess funds and use them for some purpose other than to cover losses on loans. Such transfers are not taxable if they do not exceed nondeductible additions previously made to the reserve. When made out of non-taxable funds in the reserve (additions that were

deducted from income before taxes), the transfers are, however, taxable. Such transfers are taxed as income in the year they were taken out of the reserve.

Example 1: *The reserve of a bank for losses on loans is greater than the reserve required by law or by the charter of the bank. The reserve is Afs. 10,000,000, of which only Afs. 8,000,000 came from additions deducted from income in computing income taxes. The bank transfers Afs. 2,000,000 from this reserve to build a new bank building. This transfer is not subject to income tax since the reserve contained Afs. 2,000,000 that was taxed before being added to the reserve.*

Example 2: *The reserve of a bank for losses on loans is greater than the reserve required by law or by the charter of the bank. This reserve was built entirely by additions deducted from income. In other words, all funds in this reserve were added to it free of income tax. This bank transfers Afs. 250,000 from this reserve and uses this amount to purchase equipment. Since this transfer is not in accordance with the purpose of the reserve, it is taxable in the year in which it takes place. Therefore, Afs. 250,000 is added to other taxable income and a tax of 20 per cent is assessed.*

Increase or decrease in value of securities

Article 57. An increase or decrease in value of securities owned, loans and similar items is not recognized for the purposes of this Law until realized through sale or exchange of the securities. When gain or loss is realized through sale or exchange of the securities, such gain or loss shall be income or loss in the year in which the sale or exchange took place.

57.1 Securities owned by a bank or investment company may be revalued as good banking practice and law may require. Losses or gains shown from such revaluation are not considered in computing taxable income, however. Only when a security is sold or otherwise exchanged is the gain or loss reported in taxable income.

Example 1: A bank owns stock in a corporation for which it paid Afs. 5,000,000. Over a period of 10 years these securities diminished in value and the corporation went bankrupt. These stocks were finally redeemed by a receivership for the bankrupt corporation that issued the securities. The bank receives Afs. 1,000,000 in the liquidation of the assets of the corporation in the tenth year. The loss of Afs. 4,000,000 is deductible by the bank in the year the stocks were returned, not before.

Example 2: A bank purchases securities for Afs. 5,000,000, which gradually increase in value. Five years after purchase, the bank sells these securities for Afs. 7,500,000. The gain of Afs. 2,500,000 is taxable in the year the securities are sold.

CHAPTER IX

WITHHOLDING TAXES ON INCOME SOURCES

Article 58 - Article 63

Withhold and payment of tax

Article 58 All natural or legal profit and non profit persons, ministries, state enterprises, municipalities and other State departments employing two or more employees in any month of a year are required to withhold taxes as provided in Article 4 of this Law from all salary and wage payments and pay the amount withheld to the Government account.

58.1 Individuals and legal persons who employ other persons are required to withhold taxes from salaries and wages paid.

Example 1: *An individual is in the business of building houses. He has from five to twenty workmen in his employ who earn taxable income. This individual is required to withhold taxes from salaries and wages paid to his employees.*

Example 2: *The same individual enters into a partnership with another person in order to raise capital and take on bigger construction projects. The partnership is required to withhold taxes from the wages of any workman whose wages are high enough to be taxable.*

58.2 Persons who are not on the payroll, but are hired to perform some service for remuneration that is not wages or salary, are not employees. The remuneration of such persons is not subject to tax withholding.

Example 1: *A company hires an electrician to repair the electric wiring in its warehouse. The electrician agrees to do the work for Afs. 2,000 plus cost of materials used. Since this workman is not an employee on the payroll of the company but an independent contractor, the company is not required to withhold taxes from the amount paid to him.*

Example 2: *A company hires a plumber to install plumbing in its offices. This plumber is hired with the understanding that he will be paid the retail price for all fixtures, fittings, and pipe installed, plus labor costs, and a specified percentage of profit. The company pays the plumber on this basis as billed by the plumber. The company is not required to withhold taxes since the plumber is an independent contractor.*

Example 3: *A company hires a workman to build a brick wall around its storage yard. The workmen and their supervisors are paid daily wages by the company. Even though these workmen are only temporarily on its payroll, the company is required to withhold taxes.*

Rent withholding tax on buildings and houses

- Article 59.
- (1) Payments of rent for buildings and houses which are rented to legal persons or natural persons and are used for business purposes or offices where the monthly rent is more than 15,000 afghanis are subject to a 20 percent income tax.
 - (2) Tenants of buildings and houses mentioned in paragraph (1) of this Article are required to pay taxes according to the rulings issued by the Ministry of Finance.
 - (3) Tax collected under paragraph (1) of this Article is paid by the tenant in respect of the income tax liability of the landlord under this Law. This tax shall be treated as a prepayment of the tax liability of the landlord and shall be credited at the time of annual tax payment. In the event of a dispute about the amount of rent owed by a tenant, the tenant will be treated as having paid to the landlord as rent any tax that was paid to the relevant authorities under this Article.
 - (4) Payments for rental services include:
 - any money, goods or services or any other benefit received by a person or persons for rental services; and
 - the cost of any repairs, renovations or improvements to the property carried out by the tenant.
 - (5) If the rental payment of a property is less than the actual rental value of the property, the Ministry of Finance by its authorized panel will calculate the rent according to the market value.
 - (6) Property dealers are required to send a copy of the agreement to the Ministry of Finance as soon as it is signed. If a property dealer makes a false agreement or delays sending the agreement, the Ministry of Finance will officially notify the Ministry of Justice to take necessary action.
 - (7) Where it is proven that the rent in a lease agreement is more than 20 percent lower than the market value rent, paragraph (5) of this Article will be applied. In the case of a dispute on market value of the rent, the onus is on the landlord to prove that the rate fixed by the Ministry of Finance is not correct. This provision applies where the Ministry of Finance finds evidence and documents which show that the rent mentioned in the contract is less than what is paid. In this case, the Ministry of Finance may require the landlord to lease the property to the Ministry of Finance at the end of the current lease for a period twice the period set out in the current lease for the rental price set out in the current lease.
 - (8) If the tax has not been paid within 15 days of the due date, the following rules will apply:

- (1) Subject to a notice in writing by the Ministry of Finance, the right of the landlord in a lease agreement or similar contract to receive payment for rental services shall be treated as if it has been temporarily transferred to the Ministry of Finance as representative of the Government of Afghanistan;
- (2) If the tenant has not paid the tax due within 30 days after receiving notice from the Ministry of Finance of the amount overdue, the right of the landlord in a lease agreement or similar contract to evict tenants for non-payment of rent shall be treated as if it has been transferred to the Ministry of Finance as representative of the Government of Afghanistan.

This arrangement will remain in place until the Ministry of Finance receives the rental tax due and any additional income tax payable in accordance with Chapter XVI of this law.

59.1 Legal or natural persons that pay rent for the use of buildings for business purposes or office space must withhold 20 percent of the total rental payment if the rent exceeds 15,000 Afghanis per month. Where the total rental payment is 15,000 Afghanis or less per month, then no withholding tax is payable. In both cases, the rental income will be subject to annual income tax under Article 4 of the Income Tax Law.

Example 1: *Najibullah rents some office space in the Wazir Akbar Khan area of Kabul. Najibullah pays Afs. 20,000 per month. Najibullah must withhold Afs. 4,000 per month.*

Example 2: *Azziz rents an apartment in the Shar-e-naw area of Kabul. Azziz pays Afs. 30,000 per month. Because the payments are made for personal accommodation that is not used in a business, Azziz is not required to withhold any tax from the rental payment.*

Remark: *While Azziz is not required to withhold tax from the payments, the owner of the apartment is liable to pay income tax on the rental income that the owner receives.*

59.2 Natural and legal persons required to withhold tax from their rental payments must transfer the tax over to an authorized bank within 15 days of the month following the month in which the rental payment is made.

Example: *Najibullah rents some office space for use in a business. The rent is Afs. 20,000 per month. The first payment is due on the first of Jawza. Najibullah will pay Afs. 16,000 to the landlord and will withhold Afs. 4,000. The Afs. 4,000 should be remitted to the bank by the 15th day of Saratan.*

- 59.3 The amount withheld by the tenant is treated as a prepayment of the landlord's income tax liability with respect to the rental income. To claim the withheld amount as a credit, the landlord must file an income tax return.

Example: An Afghan corporation rents office space from Wais, an Afghan resident and landlord. The Afghan corporation is obligated to pay Afs. 300,000 of rent during the year. Of this amount, only Afs. 240,000 is actually paid by the Afghan corporation to Wais. The remaining Afs. 60,000 is withheld and paid over to the government. Wais files his income tax return for the year and records Afs. 300,000 of rental income. Wais does not have any other income. Wais has Afs. 20,000 of deductible expenses. Thus, Wais's taxable income is Afs. 280,000. Wais does not have to pay any tax on the first Afs. 150,000 he earns, under Article 4 of the Income Tax Law. On the remaining Afs. 130,000 of income, he needs to pay 10% or Afs. 13,000. Because Wais has already had Afs. 60,000 withheld from his rental income, Wais is entitled to a refund of Afs. 47,000. To obtain this refund, Wais must file an income tax return.

- 59.4 Payments for rental services include any benefit that the tenant confers on the landlord's property including repairs paid for by the tenant.

Example: An Afghan corporation rents warehouse space from Wais. The Afghan corporation makes monthly rental payments to Wais. Each month's rent is Afs. 200,000. The corporation pays to have the heating system repaired in the warehouse for Afs. 500,000 in the month of Saratan. The cost is not reimbursed by Wais. The Afs. 500,000 payment is considered additional rent paid from the corporation to Wais and is therefore subject to withholding. Rather than pay Afs. 200,000 to Wais during the month of Saratan, the corporation should withhold Afs. 40,000 in the normal course and should withhold an additional Afs. 100,000 to reflect withholding on the repair payment. Only Afs. 60,000 should be paid over to Wais.

- 59.5 The Ministry of Finance has the power under Article 102 to increase the rental value of property if the rates charged are lower than market value rates.

Example: Azziz rents some office space to his son, Najibullah, for Afs. 20,000 per month. Azziz rents similar space in the same area to unrelated parties for Afs. 50,000 per month. The Ministry of Finance has the right to cause Najibullah to withhold Afs. 10,000 per month (20% x Afs. 50,000), even though Najibullah is only paying Afs. 20,000 per month. This is because the rents that were charged were not arm's length and so the Ministry of Finance has the right to increase the rental payments.

- 59.6 Legal or natural persons that are in the business of renting land and buildings for profit are required to forward each rental agreement they execute to the Ministry of Finance (attention Afghanistan Revenue Department) or the tax office in the district in which the landlord resides or is based.

59.7 In the event that the rent withholding tax is not paid within 15 days of the day it is due, the following events may occur:

- 1) The Ministry of Finance may, at its discretion, provide a notice in writing to the tenant that the landlord's right to receive payment has been transferred to the Ministry of Finance, as representative for the Government of Afghanistan.
- 2) The tenant has 30 days from the date that it receives the notice referred to in paragraph (1) to pay over the appropriate amount of tax. If the tenant fails to pay over the correct amount of tax, the landlord's right to evict tenants for non-payment of tax shall be transferred to the Ministry of Finance as representative of the Government of Afghanistan.

Remittance of tax payments

Article 60 Any employer required to withhold taxes by Article 58 of this Law is required to remit to the State the amount withheld no later than 10 days after the end of the month in which the amounts were withheld. The employer shall submit with this remittance a Tax Withholding Report in such form as is prescribed in the Income Tax Manual of the Ministry of Finance.

- 60.1 An employer must withhold tax from the wages paid to its employees. An employer does not need to withhold tax from the payments made to independent contractors.
- 60.2 An employer must withhold tax from the wages that it pays to its employees pursuant to the tables set forth below:

Monthly Payrolls

Income more than	Income not more than	Tax
Afs. 0	Afs. 12,500	Afs. 0
Afs. 12,500	Afs. 100,000	10% of amount over Afs. 12,500
Afs. 100,000		Afs. 8,750 + 20% of the amount over Afs. 100,000

Semi-Monthly Payrolls

Income more than	Income not more than	Tax
Afs. 0	Afs. 6,250	Afs. 0
Afs. 6,250	Afs. 50,000	10% of amount over Afs. 6,250
Afs. 50,000		Afs. 4,375 + 20% of the amount over Afs. 50,000

Weekly Payrolls

Income more than	Income not more than	Tax
Afs. 0	Afs. 2,885	Afs. 0
Afs. 2,885	Afs. 23,077	10% of amount over Afs. 2,885
Afs. 23,077		Afs. 2,019 + 20% of the amount over Afs. 23,077

For daily payrolls

Income more than	Income not more than	Tax
Afs. 0	Afs. 411	Afs. 0
Afs. 411	Afs. 3,288	10% of amount over Afs. 411
Afs. 3,288		Afs. 288 + 20% of the amount over Afs. 3,288

Example: Aziz employs two individuals, Najib and Wahid, in his construction business. Najib and Wahid are employees and not independent contractors. Najib and Wahid are paid every week. Najib earns Afs. 3,600 per week. Wahid earns Afs. 24,000 per day and works six days a week. Aziz must withhold Afs. 72 from Najib's pay every week. Aziz must withhold Afs. 22,204 from Wahid's pay every week.

- 60.3 The employer must deposit the amounts withheld with an authorized bank no later than 10 days after the end of the month in which the amounts were withheld. Each deposit should be accompanied by a "Report of Tax Withholding and Bank Deposit Form for Employers." This form can be obtained from the Ministry of Finance.

An electronic funds transfer option is also available. Please refer to Guide 06 which can be found on the Ministry of Finance website.

Preparation of Statements

Article 61 (1) Each employer required to withhold tax from salaries or wages shall prepare a salary and tax statement for each employee and submit the statement to the Ministry of Finance or relevant tax office and employees no later than the end of the first month of the following year as prescribed by the Ministry of Finance.

(2) Every employer prescribed in paragraph (1) of this Article is required to file an annual summary report of taxes withheld from salaries and wages in the form and at the time and place prescribed by the Ministry of Finance.

61.1 The employer and employee have certain reporting obligations with respect to wage withholding that have to be complied with.

- a) Every year, the employer must prepare an Annual Salary and Tax Statement for each employee subject to wage withholding. At any time that an employee ceases employment, the employer should provide the Annual Salary and Tax Statement at the time of cessation of employment.
- b) In addition, the employer must prepare an Annual Summary Report of Taxes Withheld and Wage and Tax Statement Transmittal Form. The purpose of this form is to provide the Ministry of Finance with a summary of all of the amounts that the employer has withheld from all of its employees during the year.

Time for submission of statements

- Article 62
- (1) Every taxpayer is required to present his annual salary and tax statement to the relevant tax office within one and half months after the end of the fiscal year.
 - (2) The income tax liability for a taxable year is discharged by a person filing his salary and tax statement, certified by his employer, within one and half months after the end of the taxable year, provided the taxpayer meets the following conditions:
 1. The taxpayer has no taxable income in the taxable year other than the salary or wage from which taxes were withheld;
 2. The taxpayer was not employed during the taxable year by more than one employer; and
 3. The taxes withheld were in accordance with income tax rates prescribed in paragraph 3 of Article 4 of this Law.

- 62.1 Every taxpayer that is an employee subject to wage withholding should receive a white copy and a green copy of a wage withholding statement from his or her employer.
- 62.2 If the following requirements are met, the taxpayer does not have to file a tax return. Instead, the taxpayer must simply file the white copy of his or her wage withholding statement with the local tax office.
- a) The taxpayer has no taxable income in the taxable year other than the salary or wage from which taxes were withheld.
 - b) The taxpayer was not employed during the taxable year by more than one employer.
 - c) The taxes withheld were in accordance with income tax rates prescribed in paragraph 3 of Article 4 of this Income Tax Law.
- 62.3 If any of the requirements set forth in Article 62.2 are not satisfied, then the taxpayer must file a return in accordance with Article 63.
- 62.4 If all of the requirements set forth in Article 62.2 are satisfied, but the taxpayer has deductions to claim (e.g., the losses described in Article 18(1)9), the taxpayer may, at its option, file a tax return in accordance with Article 63.

Submission of Return

Article 63 Any taxpayer with income from salaries or wages subject to tax withholding from more than one employer or has income from sources other than salaries or wages shall file an income tax return as provided by the provisions of this Law. The taxes withheld shall be allowed as a credit against the taxpayer's tax liability.

- 63.1 A person meeting the conditions of Article 62 of the Income Tax Law, who has paid his income tax through the withholding of taxes from his salary, is not required to file an income tax return. He must, however, file a copy of the Annual Salary and Tax Statement received from his employer. He must also be prepared to show that he has met the conditions of Article 62 of the Income Tax Law.
- 63.2 The amount of withholding shown on the wage withholding form is an advance payment of tax due, not the employee's final tax liability. The taxpayer's income tax return shows the taxpayer's final tax liability. If the amount withheld exceeds the amount shown as due on the taxpayer's tax return, the taxpayer is entitled to a refund. If the amount withheld is less than the amount shown as due on the taxpayer's return, the taxpayer must remit additional funds to pay those taxes.

Example: An Afghan corporation employs Wahid. The Afghan corporation pays Wahid Afs. 150,000 per month, or Afs. 1,800,000 per year. The Afghan corporation withholds Afs. 225,000 of tax. In addition to his wages, Wahid receives investment income from a note receivable of Afs. 20,000. Wahid's tax liability is as follows:

Wages	Afs. 1,800,000
Investment Income	<u>Afs. 20,000</u>
SubTotal	Afs. 1,820,000
Income Tax Payable	Afs. 229,000
Taxes Withheld	(Afs. <u>225,000</u>)
Net Tax Payable	Afs. <u>4,000</u>

CHAPTER X

BUSINESS RECEIPTS TAX

Article 64 - Article 67

Business receipts tax

- Article 64 (1) The business receipts tax is imposed on the business activities of limited liability companies, corporations, general partnerships and organizations.
- (2) Natural and legal persons deriving 100,000 afghanis or more income per month from providing taxable services mentioned in paragraph (2) of Article 65 of this Law are subject to tax mentioned in sub-paragraph 1(6) of Article (65) of this Law.

64.1 Generally, the business receipts tax applies to limited liability companies, corporations, general partnerships and organizations. The business receipts tax does not apply to individuals except in the case outlined in Article 64(2).

Example 1: A government enterprise owned by an agency of the State manufactures and sells office furniture. Its receipts from sales are subject to the business receipts tax of two per cent.

Example 2: A government enterprise owned by an agency of the State provides telecommunication services. Its receipts from these services are subject to the business receipts tax of ten per cent.

Example 3: An Indian family in Kabul is recognized as a corporate business organization in India and is engaged in lending money and exchanging money and exchanging currencies. The receipts of this family from interest on loans and commissions on currency exchange are subject to the business receipts tax of five per cent.

Example 4: A manufacturing business which is a limited liability company is owned by an estate which has not been divided among the heirs. The undivided estate functions as a unit in managing the business, receiving income, and paying expenses. The receipts of the business from sale of products would be subject to the business receipts tax of two per cent.

Example 5: Azziz, an Afghan individual resident, operates a restaurant in Kabul. The restaurant generates the following amounts of revenue in the following months:

Month	Revenue
1. Hamal	Afs. 150,000
2. Saor	Afs. 120,000
3. Jowza	Afs. 110,000
4. Saratan	Afs. 90,000
5. Asad	Afs. 80,000
6. Sunbala	Afs. 95,000
7. Mizan	Afs. 50,000

8. <i>Agrab</i>	Afs. 45,000
9. <i>Qaus</i>	Afs. 50,000
10. <i>Jeddi</i>	Afs. 100,000
11. <i>Dalua</i>	Afs. 80,000
12. <i>Hoot</i>	Afs. 80,000

Because Azziz generated at least Afs. 100,000 during four months of the year from the provision of restaurant services, Azziz is required to pay business receipts tax for those months.

Rates of business receipts tax

Article 65. (1) The business receipts tax is collected from limited liability companies, corporations, general partnerships and organizations as follows:

1. Five percent of the gross receipts (before any deductions) during the fiscal year of commissions, fees, interest, dividends, rent, royalties, and similar income. However, the business receipts tax does not apply to the rental income of a natural person from which tax has been withheld under Article 59 of this Law.
2. Two percent of the gross receipts (before any deductions) during the fiscal year for materials, equipment, services, transportation, and construction of buildings provided under terms of a contract.
3. Two percent of the gross receipts (before any deductions) during the fiscal year from premium income for insurance.
4. Two percent of the gross receipts (before any deductions) during the fiscal year from sale of admissions to public entertainment including cinema shows, plays, concerts, exhibitions, sports and others of the same kind.
5. Two percent of the gross receipts (before any deductions) during the fiscal year from sales of products, goods, assets, and other services.
6. Ten percent of the income derived from the services provided by a legal or natural person which is 100,000 afghanis or more per month in accordance with rulings issued by the Ministry of Finance.

(2) Taxable services mentioned in sub-paragraph (1) 6 of this Article are guest house and hotel services, restaurant services, telecommunications services, and airline services:

"guest house and hotel services" means the provision of sleeping accommodation and related services, including the provision of meals, beverages, laundry and communications services, to persons who occupy such accommodation as transient guests;

"restaurant services" means the provision of food or beverages by an establishment that provides facilities for immediate consumption at that establishment, or catering services of prepared food; or sales of cooked foods that were prepared on the premises;

"telecommunications services" means the provision of telephonic services or internet services by a telecommunications service provider or internet service provider, including digital or analogue telephone, facsimile or data transfer communications, and internet access by any means;

"airline services" means passenger air services where the flight originates in Afghanistan.

(3) Total income of a business entity is not severable.

(4) The monthly receipts of a person for the provision of taxable services include money, goods and services. The cost of goods and services are computed in afghanis according to market value.

(5) Where a taxpayer referred to in paragraph 1 (6) of this Article claims that it does not have income from taxable services for one or more months, the person is required to inform the Ministry of Finance in writing and attach with a completed tax return. Where the claim is true, the person will not be subject to business receipts tax under the paragraph 1(6) of this Article. If the claim is not true then, in addition to the business receipts tax payable under paragraph 1(6) of this Article, the person will be required to pay the additional tax provided in paragraph 2 of Article 103 of this Law.

65.1 Commissions, fees, interest, dividends, rent, royalties, and similar income are all considered "business receipts" that are subject to the business receipts tax at a 5% rate. Although interest is considered a business receipt, bank deposits and repayments of loans are not considered "business receipts" that are subject to business receipts tax.

Example 1: A bank receives Afs. 2,400,000,000 from deposits in a taxable year. These deposits are not considered taxable business receipts. The gains and interest received by the bank from the investment of these deposited sums are considered taxable business receipts.

Example 2: If a bank receives Afs. 1,300,000,000 from borrowers during a taxable year in repayment of the principal of loans, none of these receipts are taxable. Interest received on those loans is considered a taxable business receipt, however.

Example 3: A bank is subject to business receipts tax of five percent on all of its income from interest on loans, dividends from investments, currency conversion charges, safety box rentals, discounts on commercial paper, commissions from sales of investments, service charges of various kinds, etc. If the bank sells any tangible items, its receipts from such sales is subject to a tax of two percent. Thus, sale of checkbooks, bookkeeping supplies, etc., is taxed at two percent, not five percent.

65.2 There is a difference between a retailing company that sells goods "on consignment" and a distributor that purchases goods for resale. Retailers that sell goods on consignment are subject to a tax of five percent of the commissions earned from such sales, whereas retailers that purchase goods and resell them are subject to business receipts tax of 2 percent according to paragraph 5 of Article 65(1).

Example 1: A travel agency sells tickets for a number of different airlines. It receives a commission on each ticket it sells. It also sells souvenir types of merchandise which it orders on consignment, receiving a commission on any sales which it makes. It further sells other merchandise which it has purchased for resale. This travel agency will pay business receipts tax of five percent on its commissions from the sale of tickets, and five percent on its commissions from the sale of consignment merchandise. Both of the commissions are covered by subparagraph 1 of Article 65(1). The travel agency will only pay business receipts tax of two percent on proceeds from the sale of merchandise purchased for resale, however. Those sales are subject to subparagraph 5 of Article 65(1).

Remark: While the travel agency is liable to 5% tax on the commissions it makes from airline ticket sales, the airlines themselves are also liable to 10% business receipts tax in respect of the ticket sales, where the flights “originate in Afghanistan”.

- 65.3 The ordinary income from intangible investments such as bonds, shares of stock, mortgages, and loans to customers is subject to the business receipts tax of five percent. Thus, interest on a bond, or dividends on a share of stock is subject to business receipts tax at five percent. Proceeds representing the principal of investments are not subject to business receipts tax, however. The receipt of the principal of bonds upon maturity is not subject to business receipts tax. Proceeds from the sale of investments held for income are receipts from sale of capital assets are not subject to business receipts tax.

Example 1: An insurance company invests its reserve funds in bonds of the State, shares in corporations, real estate mortgages, and other income-producing investments. Its receipts of income in the form of interest, dividends, and similar yields of the investments are subject to business receipts tax of five percent; but its receipts from the sale of any of these investments are not subject to either five percent or two percent business receipts tax. It is not relevant whether the company generates a capital gain on the sale or not.

Example 2: A bank invested Afs. 5,000,000 in bonds of the State yielding eight percent interest annually and maturing 10 years after date of issue. Two years later, interest rates had declined generally and these bonds were sold at a price which was Afs. 200,000 more than the Afs. 5,000,000 principal. Of these proceeds of sale the amount Afs. 5,000,000 is not subject to business receipts tax and only Afs. 200,000 is subject to business receipts tax of five percent, that is, a tax of Afs. 10,000. The increase in bond value is similar to interest and is not to be considered a capital gain for purposes of the business receipts tax.

Example 3: An investment and loan company has invested part of its funds in shares of a manufacturing corporation. Its dividend income from these shares (including taxes withheld) is subject to the business receipts tax of five percent. Three years after investing in these shares, when the

investment and loan company sold these shares to obtain funds for making loans, the market price of the shares had advanced and a capital gain was realized. None of the proceeds of this sale are subject to business receipts tax. The capital gain is subject to income tax only.

- 65.4 The gross revenue from the sale or provision of materials, equipment, services (other than services described in Article 65 (2)), transportation, and construction services provided under terms of a contract is subject to business receipts tax at a 2% rate. It is not relevant whether the contract is oral or written.

Example 1: *An Afghan corporation purchases electric generators from an unrelated corporation in China. The Afghan corporation sells the generators to customers in Afghanistan. The revenue from the sale of the generators is considered a “business receipt” and is subject to the business receipts tax.*

Example 2: *An Afghan corporation purchases electric generators from an unrelated corporation in China. The Afghan corporation sells the generators to unrelated parties in Iran. The revenue from the sale of generators is considered a business receipt and is subject to the business receipts tax even though the sales are made to customers in Iran.*

Example 3: *An Afghan corporation purchases spare automotive parts from an unrelated manufacturer in China. The Afghan corporation’s cost for mufflers is Afs. 35,000 per unit. The Afghan corporation sells the mufflers for Afs. 40,000 per unit. The entire Afs. 40,000 is considered a business receipt and is subject to 2% business receipts tax. No deduction is permitted for cost of goods sold.*

Example 4: *An Afghan partnership agrees to provide construction services to the owner of a plot of land in the Wazir Akbar Khan area of Kabul, Afghanistan. The partnership agrees with the owner that the partnership will construct a four storey building on the owner’s land. The owner and the partnership never put the contract in writing. The revenue generated by the partnership in constructing the building is considered a business receipt and is subject to business receipts tax at a 2% rate. The fact that the contract was not put in writing is not relevant.*

- 65.5 Insurance premiums constitute business receipts that are subject to business receipts tax at a 2% rate.

Example 1: *An insurance company sells car insurance to an Afghan individual for premiums of Afs. 1,000 per year. The premium is considered a “business receipt” and, as such, is subject to a 2% business receipts tax.*

Example 2: *An insurance company will pay the two percent business receipts tax on all receipts of insurance premiums. It will also pay five percent business receipts tax on all receipts of commissions, interest, and dividends from its investments. Thus, an insurance company with premium income of Afs. 11,000,000 and dividend interest and commissions income of Afs. 600,000 will pay the following business receipts tax:*

2 percent of Afs. 11,000,000	Afs. 220,000
5 percent of Afs. 600,000	Afs. <u>30,000</u>
Total business receipts tax	Afs. 250,000

- 65.6 Revenues from the sale of admission to public entertainment including cinema shows, plays, concerts, exhibitions, sports and similar events are considered business receipts that are subject to tax at a 2% rate.

Example: *An Afghan partnership owns a movie theatre in Shar-e-naw. The movie theater charges Afs. 150 per ticket. The revenue from ticket sales is considered a business receipt and is subject to business receipts tax. It is not relevant whether the attendees are Afghan residents or not.*

- 65.7 Revenues from the sale of products, goods, assets and other services are business receipts subject to business receipts tax at a 2% rate. A corporation or limited liability company will be liable to pay two percent of all receipts from sales of merchandise less any "returns." Merchandise returned by customers is not considered an expense but is instead considered sales that are returned. The refunds made for such returns may be subtracted from total receipts before applying the two percent tax.

Example 1: *A bus company is subject to business receipts tax of two percent of the passenger fares. If the total receipts from fares is Afs. 2,500,000 in a year, the two percent business receipts tax will be Afs. 50,000.*

Example 2: *A bank sells bonds of the State and receives a small commission for handling such sales. In a taxable year, the bank sells bonds for a total amount of Afs. 25,000,000, for which it receives a commission of Afs. 125,000. Although the proceeds of sale, Afs. 25,000,000, are not subject to business receipts tax, the commission of Afs. 125,000 is taxed at the five percent rate.*

- 65.8 The use in paragraph 5 of Article 65(1) of the word "assets" in conjunction with the words "goods" and "services" limits its meaning to assets which are part of the stock-in-trade of the company. The receipts from the sale of assets in which the company is dealing (buying and selling as a business) are subject to the business receipts tax of two percent.

Tangible capital assets are different from assets that are part of the stock-in-trade of the company. Receipts from the sale of tangible capital assets are not

subject to the business receipts tax. Tangible capital assets include physical assets and investments which the company owns and uses in its business.

- 65.9 Business receipts tax at the 10 percent rate applies to income derived by a legal or natural person where the amount exceeds Afs. 100,000 per month from the provision of guesthouse and hotel services, restaurant services, telecommunications services or airline services. Where the threshold amount is met, the business receipts tax will payable on the total amount of income derived.

Where the amount of income derived from the provision of such services is Afs 50,000 or less per month then, in the case of legal persons, the gross receipts from such services will be subject to business receipts tax at the rate of 2 percent (paragraph 2 or 5 of Article 65(1)), and in the case of individuals, no business receipts tax will be payable.

- 65.10 The total income of a business is not severable. This means that a business cannot artificially divide the business into separate business components so that the revenue from those components comes under the taxable threshold.

Example: *Daoud operates a restaurant with his brother Wahid. The receipts from the business total 150,000 afghanis a month, with a little less than half from the sale of drinks and deserts and a little more than half from the provision of meat dishes. Daoud and Wahid decide to divide the business into two, with Daoud supplying customers with drinks and deserts and Wahid supplying customers with meat dishes. Both brothers claim to be exempt from the business receipts tax because they are below the 100,000 afghanis per month threshold and they are natural persons.*

While Daoud and Wahid claim to be operating separate legal businesses, the two parts actually form a single business in a commercial sense. Customers in the restaurant do not distinguish between the two parts. Although the meat menu is different from the drinks and desert menu, customers view the dishes ordered as part of a single meal from a single business. The Ministry of Finance will apply Article 65(3) to combine the incomes and treat it as the income of the business which will be attributed to the brother who has the higher income.

No effect of profit or loss on business receipts tax

Article 66 Business receipts tax is payable on total receipts and is not affected whether the taxpayer has a profit or loss during the current or previous years.

66.1 The amount of the business receipts tax owed will be unaffected by the financial position of the company. The amount of tax is based on the total receipts of the company during the taxable year.

Example: *During one taxable year, a company has total receipts of Afs. 500,000 subject to the business receipts tax, and during the taxable year it sustains a loss of Afs. 150,000. In another taxable year the same company has the same amount of receipts subject to the business receipts tax but, instead of a loss, it has a profit of Afs. 150,000. In both cases the company must pay the same amount of business receipts tax on its total receipts of Afs. 500,000. The amount of income tax liability does not change the amount of business receipts tax due.*

Deductible amount

Article 67. The business receipts tax paid or payable shall be a deductible expense in computing taxable income for the same taxable year.

67.1 The amount of the business receipts tax is to be considered as an ordinary and necessary expense of doing business, and should be deducted from income when computing a taxpayer's income tax liability.

Example: An Afghan corporation sells generators and earns Afs. 10,000,000 revenue during the year. The corporation has wage expense of Afs. 400,000 and other operating expenses of Afs. 250,000. The Afghan corporation computes its taxable income as follows:

Total Revenue		10,000,000
Business receipts tax	(200,000)	
Wage Expense	(400,000)	
Operating Expenses	(250,000)	(850,000)
Taxable Income		<u>150,000</u>

Remark: Business receipts tax is a tax on the person who derives revenue from business. It is for the Afghan corporation to decide whether it wishes to separately itemize the amount of business receipts tax it may wish to pass on to the customer. As business receipts tax applies to the gross revenue of the Afghan corporation, it is irrelevant whether business receipts tax is separately itemized and paid for by the customer or not.

CHAPTER XI

FIXED TAXES

Article 68 - Article 81

Fixed tax on commercial activities

Article 68. Persons who are engaged in commercial activities or who own the properties described in this Chapter are subject to fixed tax.

68.1 In general, fixed taxes are imposed in lieu of income taxes. Fixed taxes can apply to individuals, partnerships, limited liability companies and corporations.

Payment of fixed tax

Article 69. Fixed taxes are due and payable during the taxable year unless otherwise provided in this Law.

- 69.1 For details regarding when each of the fixed taxes prescribed in this Chapter are due and payable, reference should be made in the first instance to the relevant Article prescribing the fixed tax. In the case where the Article does not state when the fixed tax is due and payable, reference should be made to Article 93.

Fixed tax on imports

- Article 70.
- (1) Persons who import goods and have a business license are subject to two percent fixed tax on the total cost (including custom duties) of the goods imported. The tax paid will be allowed as a credit in the calculation of the person's annual income tax assessment in accordance with the provisions of this Law.
- (2) Persons who import goods without having a business license are subject to three percent fixed tax on the total cost (including customs duties) of the goods imported in lieu of income tax on such activities.
- (3) Persons who import goods and have an interim business license but do not provide their business declaration form to the Ministry of Finance are subject to three percent fixed tax on the total cost (including customs duties) of goods imported in lieu of income tax on such activities.
- (4) The tax mentioned in the paragraphs of this Article shall be paid at the customs house where customs duties of the goods are paid.

- 70.1 Taxpayers that have a business license are subject to a tax on their imports. The tax equals 2% of the value of the goods imported. The 2% tax is an advance payment of income tax due and payable. The 2% tax may be larger or smaller than the taxpayer's actual net income tax liability. The taxpayer's payment of the 2% advance tax does not excuse the taxpayer from his obligation to file an income tax return.

Example 1: *An Afghan corporation imports goods worth Afs. 20,000,000 during the year 1385. The Afs. 20,000,000 value includes customs duties applied. The corporation must pay Afs. 400,000 in addition to the customs duties that it has to pay. After the end of 1385, the Afghan corporation is required to file a tax return. The tax return shows the following results:*

Revenue		100,000,000
BRT	(2,000,000)	
Operating Expenses	(40,000,000)	
Interest Expense	(18,000,000)	(60,000,000)
Taxable Income		40,000,000
Tentative Tax Liability (20%)		8,000,000
Advance Tax Payment		(400,000)
Tax Due		7,600,000

Example 2: *An Afghan corporation imports goods worth Afs. 40,000,000 during the year 1385. The Afs. 40,000,000 includes the customs duties that are due. The corporation must pay Afs. 800,000 in addition to the*

customs duties that it has to pay. After the end of 1385, the Afghan corporation is required to file a tax return. The tax return shows the following results:

Revenue		100,000,000
BRT	(2,000,000)	
Operating Expenses	(84,000,000)	
Interest Expense	<u>(11,000,000)</u>	<u>(97,000,000)</u>
Taxable Income		3,000,000
Tentative Tax Liability (20%)		600,000
Advance Tax Payment		(800,000)
Tax Refunded		(200,000)

Remark: It is important to note that if the Afghan corporation fails to file an income tax return, the corporation will not be entitled to receive its Afs. 200,000 tax refund.

- 70.2 Taxpayers who do not have a business license (or who have an interim business license but have not provided a business declaration form to the Ministry of Finance) are also subject to a tax on their imports. The tax equals 3% of the value of the goods imported. The 3% tax is payable in lieu of income tax.

Fixed tax on exports

- Article 71.
- (1) Persons who export goods and have a business license are subject to two percent fixed tax on the total cost (including custom duties) of the goods exported. The tax paid will be allowed as a credit in the calculation of the person's annual income tax assessment in accordance with the provisions of this Law.
 - (2) Persons who export goods without having a business license are subject to two percent fixed tax on the total cost (including customs duties) of the goods exported in lieu of income tax on such activities.
 - (3) Persons who export goods and have an interim business license but do not provide their business declaration form to the Ministry of Finance are subject to two percent fixed tax on the total cost (including customs duties) of the goods in lieu of income tax on such activities.
 - (4) The tax mentioned in the paragraphs of this Article shall be paid at the customs house where customs duties of the goods are paid.

- 71.1 The application of Article 71 of the Income Tax Law is just like the application of Article 70 of the Income Tax Law, the only difference being that the tax rate for those without a business license (or who have an interim business license but have not provided a business declaration form to the Ministry of Finance) is 2% rather than 3%. Article 70 applies to importers whereas Article 71 applies to exporters. All of the regulations and instructions related to Article 70 are applicable to Article 71 as well, taking into account the exporting nature of Article 71.

Fixed tax on transport

Article 72. Persons who transport passengers or goods for business purposes are required to pay an annual tax as follows, before renewal of their vehicle registration:

No.	TYPE OF VEHICLE	TAX
1	<i>Vehicles Based on Tons</i>	
1	From 1 up to 2 tonnes	2600 afs.
2	Over 2 up to 3 tonnes	3400 afs.
3	Over 3 up to 4 tonnes	4200 afs.
4	Over 4 up to 5 tonnes	5000 afs.
5	Over 5 up to 6 tonnes	6000 afs.
6	Over 6 up to 8 tonnes	7500 afs.
7	Over 8 up to 10 tonnes	9000 afs.
8	Over 10 up to 12 tonnes	10500 afs.
9	Over 12 up to 14 tonnes	12000 afs.
10	Over 14 up to 16 tonnes	13500 afs.
11	Over 16 up to 18 tonnes	15000 afs.
12	Over 18 up to 20 tonnes	16500 afs.
13	Over 20 up to 25 tonnes	18500 afs.
14	More than 25 tonnes	18500 afs and 500 afs per additional tonne
15	More than the total allowable tons of a trailer	Over 500 kg then 200 afs per tonne
2	<i>Passenger Vehicles</i>	
1	Taxi with capacity of 3 to 5 passengers	2000 afs.
2	Taxi with capacity of more than 5 passengers	2000 afs. and 200 afs. per additional seat
3	Microbus with up to 14 seats	2600 afs
4	Other buses from 15 up to 21 seats	4000 afs
5	Other buses from 22 up to 29 seats	6000 afs
6	Other buses from 30 up to 39 seats	7000 afs
7	Other buses from 40 up to 49 seats	7500 afs
8	Other buses from 50 up to 60 seats	8000 afs
9	Other buses with more than 60 seats	8000 afs and 200 afs per additional seat
3	<i>Vehicles according to their cylinders</i>	
1	4 cylinders	1500 afs per vehicle
2	6 cylinders	2000 afs per vehicle
3	8 cylinders	3000 afs per vehicle
4	More than 8 cylinders	3000 afs and 500 afs per additional cylinder
4	<i>Rickshaw</i>	
1	Motorbike rickshaw	500 afs
2	Rickshaw	1000 afs.

72.1 The tax specified in Article 72 of the Income Tax Law is collected from the owners of vehicles used in the business of transporting persons or property as listed in this Article.

Example 1: From a person owning two taxis Afs. 4,000 per year is received as fixed tax on the operation of his taxi as provided for in Article 72 of the Income Tax Law.

Example 2: *A man has a truck which has a capacity of two tons. This man must pay Afs. 2,600 per year as fixed tax on his truck.*

Example 3: *The fixed tax of a vehicle is not limited to a category or class solely because of its description but may be assigned another category because of its use.*

A one-ton truck ordinarily rated at the 2,600 afghani rate is used as a taxi carrying passengers equivalent to a bus. The fixed tax imposed will be the bus rate of 4,000 Afs.

Example 4: *A man who has an animal-drawn carriage (used to transport persons or goods for money) operates a “rickshaw” and must pay Afs. 1,000 per year as fixed tax on his carriage.*

- 72.2 The fixed tax of Article 72 of the Income Tax Law is in lieu of an income tax on income from such vehicles. In case the owner has other income subject to income tax, the income received from the operation of a vehicle listed in Article 72 should be noted but not included in his income return.
- 72.3 The fixed tax provided in Article 72 of the Income Tax Law is paid at the tax office of the district in which the owner resides. If the place of residence of the owner and the place where the highway-use license is issued are not the same, then the fixed tax is paid in the tax office of the place where the highway-use license is issued.

Fixed tax of government contractors

Article 73. Persons without a business license who provide supplies, materials, services or construction under contract to the State or its agencies are subject to a seven percent fixed tax in lieu of taxes on income from such activities. Fixed tax is to be withheld from the amount to be paid.

73.1 The fixed tax provided in Article 73 of the Income Tax Law is paid on income of natural and legal persons who do not have a Afghan business license and who furnish supplies, materials, or services to the State under contract or who do construction work under contract. Such a person is required to pay, in lieu of taxes on income from such activities, a tax at the time the contract is made or the payment is received.

Example 1: *A Chinese corporation supplies communications equipment directly to the Ministry of Communications pursuant to a contract. The Chinese corporation ships the equipment directly from its manufacturing facility to the Ministry of Communications, which then uses the equipment to build communications facilities in Afghanistan. The sales price in the first year is Afs. 100,000,000. The Chinese corporation does not obtain a business license in Afghanistan, because it does not have any substantial physical presence in Afghanistan. The Chinese corporation is subject to the fixed tax in Article 73. When the Treasury Department within the Ministry of Finance issues the payment to the Chinese corporation, it will withhold 7% of the amount due in satisfaction of the Chinese corporation's liability.*

Example 2: *A Chinese corporation provides sheet metal to a Pakistani contractor that operates within Afghanistan. The Pakistani contractor has a number of facilities in Afghanistan through which it builds houses and buildings. Some of the buildings that the Pakistani contractor builds are for the Ministry of Interior. The Chinese corporation does not have operations in Afghanistan and so does not have a business license to operate within Afghanistan. The Pakistani corporation does have a business license. When the Treasury Department within the Ministry of Finance issues the payment to the Pakistani corporation, the Treasury department does not need to withhold any portion of the price paid to the Pakistani corporation under Article 73, because the Pakistani corporation has a business license. Moreover, no portion of the amounts paid to the Chinese sheet metal supplier are subject to the Article 73 tax, because the Chinese entity's contract is with the Pakistani entity, not the Afghan government.*

Fixed tax of exhibitions

Article 74 Legal persons not subject to taxation under Chapter X of this Law or persons who are the owners of cinemas, theaters, exhibitions, or other places of entertainment and who at the same time operate such places, are subject to a fixed tax of ten percent of receipts from sale of admissions. This fixed tax is in lieu of income tax for such business. The fixed tax on admissions sold during each month is to be paid before the sixth day of the following month at the tax office of the district in which the showing took place.

74.1 In the case of cinemas, theaters, exhibits, carnivals or other places of entertainment:

- a. A person who only owns such a place but leases it to others, is subject to income tax according to the rate schedule of Article 4 of the Income Tax Law on their income from the lease of such property owned by them.
- b. The lessee of property and places mentioned in Article 74 of the Income Tax Law is subject to taxes provided in Article 74 of the Income Tax Law.
- c. The person who is the owner of the property and places mentioned in Article 74 of the Income Tax Law and who at the same time operates such places, is only subject to the fixed tax on admissions provided in Article 74 of the Income Tax Law.

Example 1: *Wahid owns a cinema in Paghman and at the same time operates it. If Wahid receives Afs. 375,000 in the month of Saraton, 1385, from the sales of admission, he must pay to the State at the Paghman tax office before the sixth day of the month of Asad, 1385, ten per cent of Afs. 375,000, that is the amount of Afs. 37,500, in lieu of taxes on income received from such ownership and activity.*

Example 2: *If the owner of Example 1 leases his cinema out to another person for Afs. 600,000 per year, then the owner must pay income tax according to the rate schedule of Article 4 of the Income Tax Law on his income of Afs. 600,000 from his ownership; and the lessee should pay the tax on the sale of admissions according to this Article.*

Fixed Tax of Grain and Processing Mills, Cane and Seed Oil Machinery

- Article 75 (1) Owners of mills grinding grains or processing rice, cane or seed oil extracting machines are subject to a fixed tax in lieu of taxes on income from such property. This tax shall be ten percent of the estimated gross income per year from such mills or machines. The estimated gross income per year shall be determined in accordance with the Income Tax Manual of the Ministry of Finance and the tax shall be paid by the owner at the tax office of the district in which the mill or machine is located.
- (2) Owners of mills and saw mills with machines which operate by electric or diesel or similar power are subject to a fixed tax in lieu of income tax on the income from such mills. The fixed tax is equal to 400 afghanis per year per horse power of the motors or machines providing power for the mill. The tax shall be paid by the owner of the mill at the tax office of the district in which the mill is located.

75.1 There are two separate fixed taxes imposed on the operation of grain and processing mills. The tax that applies depends on how the mill is operated. Mills operated by water, wind or animal power are subject to one type of tax. Mills operated by electricity or fossil fuels are subject to a different fixed tax. Both taxes are collected in cash. Neither tax is collected in kind.

75.2 Article 75(1) of the Income Tax Law provides that the owners of flour and rice mills and cane and vegetable oil machines operated by water, wind, or animal power must pay ten per cent of the estimated gross annual income from such property in lieu of taxes on income from such property. They are not required to pay income tax based on Article 4 of the Income Tax Law for income from such property. This tax is to be paid in the tax office of the district in which the property is located.

a) In order to determine, the estimated annual gross income of the flour, rice or oil mills, a competent and informed committee is appointed for each district. This committee shall determine the estimated annual gross income of each mill of the district together with the amount of its fixed tax, and submit the lists therefore to the tax office of the district in which the flour or rice mill is located. The committee should keep in mind the following points:

1. The income on Fridays may not belong to the owner of the flour or rice mill.
2. At least several days during a year the flour or rice mill will be under repair.
3. In some districts, in some parts of the year, there may not be enough water and so the flour or rice mill may not be operated for some months.

4. In some districts, because of the non availability of grains in some parts of the year, the flour or rice mill may not be operated.
 5. The income received on one day from a flour or rice mill may not all belong to the owner of the flour or rice mill but is shared by the mill operator as well.
- b) Once the amount of the fixed tax for a flour or rice mill is established by the committee according to Regulation 75.2 a, this amount will apply in future years. If in the future any one of the conditions change to reduce the income of the flour or rice mill, the tax office of the district is obligated, when requested by the owner, to reconsider the estimation of the annual gross income of the flour or rice mill and as a result the amount of fixed tax thereon. Similarly, if any one of the conditions change to increase the income of the flour or rice mill, the tax office of the district is obligated to reconsider the estimated gross income.

Example: *If the gross income of a flour mill is estimated to be Afs. 500,000 per year, its fixed tax is established as Afs. 50,000 per year. Two years later, two new competing flour mills are built close to the old mill. If its income is affected, the tax office must reassess the income of the old mill, at owner's request.*

75.3 Article 75(2) of the Income Tax Law provides for fixed taxes on power in lieu of taxes on income from such property to be paid by the owners at 400 afghanis per horsepower per year for every mill motor. This tax is to be paid at the tax office of the district in which the mill is located.

Example: *An electric saw mill has a 5-horsepower motor. Its annual fixed tax will be $5 \times \text{Afs. } 400 = \text{Afs. } 2,000$.*

Fixed tax of place of business

Article 76. All persons selling goods and services from established places of business are subject to taxes specified under the provision of the Article 77 of this Law. These taxes are in lieu of income taxes. This tax shall be paid by the owner or owners of the business at the tax office of the district in which the business establishment is located.

- 76.1 In accordance with paragraph 6 of Article 93, persons who carry on business from fixed business establishments are required to pay their tax quarterly and the payment for each quarter must be made no later than the 15th day of the month following each quarter.
- 76.2 The fixed tax is in lieu of income taxes on the sale of goods and services from the establishment covered by Article 76 of the Income Tax Law. If the natural person taxed under Article 76 of the Income Tax Law has income from sources other than the business covered by fixed taxes in lieu of income taxes, he must report such income for taxation under the rate schedule in Article 4 of the Income Tax Law. The income from the business taxed under Article 76 of the Income Tax Law as well as the fixed tax paid under this article shall not be included in such report.
- 76.3 Corporations, limited liability companies or any person registered with the Afghanistan Investment Support Agency or the Ministry of Commerce that sell goods or services from established places of business are required to pay annual income tax. These persons will not be subject to fixed taxes according to this Article.

Determination of fixed tax on place of business

Article 77 (1) The fixed tax of business establishments is to be set by a committee considering the following factors and is to be approved by the Minister of Finance every three years:

1. The kind of goods and services offered;
2. The estimated volume of business;
3. The size and rental value of the establishment;
4. The economic advantages of its location in relation to the population;
5. Demand for goods and services offered;
6. Estimation of turnover, cost of goods and sales of goods;
7. Classification between domestic and foreign products;
8. Classification between consumable and non-consumable goods;
9. Estimation of daily, monthly and annual net income of the business establishment.

(2) A fixed tax is imposed on business establishments which do not have complete accounting documents, and is computed according to the following categories:

1. The fixed tax of business establishments which have reliable purchase documents is three percent of the total annual purchases.
2. The fixed tax of business establishments which have reliable sales documents is two percent of the total annual sales.
3. The fixed tax of business establishments which are not covered by sub-paragraphs (1) and (2) of this paragraph is 2.5 percent of the estimated total annual sales.
4. The fixed tax of business establishments whose calculation of annual net income is not possible is six percent of the market value of the current stock on hand.

77.1 The purpose of Article 77 of the Income Tax Law is to apply the tax laws to natural persons that operate businesses in an equitable manner. Quite often, these persons will not have adequate records with which an income tax can be computed. This is not the case for corporation and limited liability companies which are required by this law to keep proper accounting records. Thus, in the case of natural persons who sell goods or services from established places of business, there are five methods by which the person's

tax liability may be determined. Each method is described in detail below. The First Method may only be applied with the consent of the Minister of Finance. The remaining methods do not require the consent of the Minister of Finance.

- 77.2 First Method: The Afghanistan Revenue Department may choose to establish a committee to determine the fixed tax that should be imposed on a particular “category” of business. This category will then be separated into different grades. These grades may be increased or decreased in number or taxable amounts when facts and circumstances make it necessary. The approximate annual net income potential of the highest and lowest shop in a category is found and the annual estimated income tax of the highest and the lowest shop is computed in accordance with Article 4 of the Income Tax Law. The estimated income taxes for the highest and lowest are used as a guide to establish the tax for the number of grades selected for the category. Before this method can be used, the Afghanistan Revenue Department must submit the schedule to the Minister of Finance for approval.

Example: *The Afghanistan Revenue Department decides to include the fresh fruit shops in a schedule of categories of business establishments and set up appropriate grades and the tax for each grade. The Afghanistan Revenue Department takes the following steps:*

- a. *The Afghanistan Revenue Department finds that the largest shop in the category has an annual estimated net income potential of Afs. 600,000. The smallest shop in the category has an estimated income potential of Afs. 120,000. This determination is made based on investigation and the factors listed in Article 77(1).*
- b. *The annual income tax for Afs. 600,000 and Afs. 120,000 is computed in accordance with Article 4 of the Income Tax Law:*
 1. *Annual income tax on Afs. 600,000 Afs. 45,000*
 2. *Annual income tax on Afs. 120,000 Afs. 0*
- c. *The Afghanistan Revenue Department may, for example, propose the taxes for six grades as follows:*

Category	Grades					
	1	2	3	4	5	6
Fresh Fruit Shops	45,000	30,000	20,000	10,000	5,000	0

- d. *After the grades and the tax for each grade are established, the Afghanistan Revenue Department submits the proposal to the Minister of Finance*
- e. *After the number of grades in a category and the tax for each grade is approved by the Minister of Finance (or upon the*

Minister's authorization, the Deputy Minister of Customs and Revenue), the following steps are taken:

- 1. The Afghanistan Revenue Department appoints a committee, which should also include representatives of the business involved, to classify all business establishments included in a category.*
- 2. The committee shall be instructed by the Afghanistan Revenue Department in the procedures and methods of estimating the annual net income potential and the way of establishing the grade and tax of a business establishment. In estimating the annual net income potential, only those factors included in this Article are to be considered.*
- 3. The committee visits each of the shops in a category, establishes the grade, prepares the list of such shops with their grades and taxes, and submits it to the Minister of Finance (or upon the Minister's authorization, the Deputy Minister of Customs and Revenue).*
- 4. When classification of the committee is completed, the owner of a shop (business establishment) shall be liable to pay each year to the State the tax established for his shop.*

77.3 Second Method: If the business has reliable purchase records, but does not have reliable sales records, then the fixed tax shall be three percent of the total value of all purchases during the year.

Example: *A person owns a shop that sells electrical supplies. The person has sales receipts for three months of the year. The person has kept all of his purchase invoices, however. The fixed tax should be determined under the Second Method.*

77.4 Third Method: If the business has reliable sales records, the fixed tax shall be two percent of the total annual sales.

Example: *A person owns a shop that sells Afghan antiques. The person has kept all of his purchase records and has reliable sales receipts for the entire year. The person's fixed tax should be determined under the Third Method.*

77.5 Fourth Method: If the business does not have reliable purchase records or sales records, but its sales can be reliably estimated, then the fixed tax shall be two and one half percent of estimated annual sales.

Example: *A person owns a rug shop in Kabul. The person does not keep any purchase receipts, but instead purchases rugs from local suppliers with cash. The person does not provide sales receipts to his customers. Nevertheless, due to the number of rug shops in Kabul, the person's sales can be reasonably estimated at Afs. 500,000 per year. The fixed tax on this person should be determined under the Fourth Method.*

- 77.6 Fifth Method: If the business does not have reliable purchase or sales records, and its sales cannot be estimated, then the fixed tax shall be six percent of the market value of the business inventory on hand at the time the business is audited.

Fixed tax of physicians

Article 78 (1) Physicians or medical practitioners who treat patients outside of State hospitals are required to pay an annual fixed tax in lieu of income tax as follows:

1. 6,000 afghanis for physicians or medical practitioners who have up to 10 years of experience,
2. 10,000 afghanis for physicians or medical practitioners who have more than 10 years and up to 20 years of experience,
3. 15,000 afghanis for physicians or medical practitioners who have more than 20 years of experience.

(2) The fixed taxes mentioned in paragraph (1) of this Article are collected by the relevant section of the Ministry of Public Health while issuing or renewing medical treatment licenses.

(3) Where a person does not pay the tax due under paragraph (1) of this Article, the person's clinic or office will be closed by officials of the Ministry of Finance until the tax due has been paid.

Amendments to exemptions

Article 79 (1) Amendments to exemptions and tax rates of this Law must be proposed by the Ministry of Finance and approved by the authorized officials.

(2) Tax imposition and exemptions are not valid without the approval of the Ministry of Finance.

79.1 Article 42(2) of the Afghan Constitution prohibits the imposition of tax and duties, unless the tax or duty is enacted as a law.

79.2 Moreover, the imposition of any tax, and the exemption from any tax, shall be approved by the Ministry of Finance.

79.3 It is important to understand the difference between a “tax” and a “fee” charged for the provision of a good or a service. A “tax” is a levy imposed by a governmental body to raise revenue for the operation of government and the provision of goods and or services to the public at large. A “fee” is a reasonable charge for goods and services provided by the government to a specific taxpayer. A “fee” is reasonable if it is commensurate with the fee that would be charged by a private business to provide similar goods or services. The mere fact that a private business may be able to provide similar goods or services at a somewhat lower price does not automatically convert the “fee” into a tax. Nevertheless, if the “fee” charged is significantly higher than the charge that would be payable to a private firm, the excess portion of the fee may be considered a “tax”. In addition, the fact that people are compelled to pay the charge does not automatically mean that the charge is a tax, but it is evidence that the charge is a tax.

Example 1: *The Ministry of Information, Culture and Tourism charges individuals for brochures illustrating various locations in Afghanistan. No one is compelled to purchase the brochures. The charge is therefore a “fee” and not a “tax”. The Ministry may charge this fee even in the absence of a law authorizing it. Moreover, the Ministry may charge this fee without obtaining approval from the Ministry of Finance.*

Example 2: *The Ministry of Transportation decides to start charging every Afghan individual and business Afs. 10 per month for the use of the road. The fact that every person is compelled to pay the charge and the charge is not directly related to any good or service consumed by the people, the charge is a tax. As such, it cannot be imposed without the authority of a law. Moreover, this law should not be proposed without the permission of the Ministry of Finance.*

Fixed tax on persons without fixed place of business

Article 80. Persons with no fixed place of business and not otherwise taxed under the provisions of this Law are subject to fixed occupational tax in accordance with the provisions of Article 81. Fixed occupational tax is payable to the nearest tax office of the district in which the person resides.

80.1 Where a person has no fixed place of business, the person will be liable to pay a fixed occupational tax. The fixed occupational tax is in lieu of income tax.

Example 1: *Azziz sells fruit in Kabul using a push-cart. Every day, Azziz purchases fruit from local farmers, puts the fruit on his cart, and sells the fruit on the streets of Kabul. Azziz does not own or lease any fixed place of business. Azziz is not subject to the tax described in Articles 76 and 77, because he does not have a fixed place of business. Moreover, because Azziz is self-employed, he is not subject to the tax in Article 4. Azziz must pay the fixed tax under Article 80.*

Example 2: *The facts are the same as in Example 1, except that Azziz owns the farm on which the fruits are grown. Azziz owns the farm and the push-cart business individually. He does not own the entity through a corporation. Azziz is subject to the tax described in Articles 76 and 77. Azziz is not subject to the tax described in Article 80, because Azziz does have a fixed place of business.*

80.2 Fixed taxes on persons with no fixed place of business is due annually and payable to the nearest tax office of the district in which the person resides by the end of the first month of the following year.

Fixed tax of brokers and commission agents

Article 81. Persons who are brokers, commission agents, or sellers of goods and similar businesses without a fixed place of business shall pay tax according to the rates determined by the Ministry of Finance.

- 81.1 The Ministry of Finance may impose fixed taxes on persons without a fixed place on either of two bases.
- 81.2 The first basis is to apply a fixed tax at the rate determined by the Ministry of Finance to all persons of a particular trade or vocation no matter the range of income that may be earned by persons in that trade or vocation.
- 81.3 The second basis is to apply a fixed tax at various rates determined by the Ministry of Finance to all persons of a particular trade or vocation taking into account the following factors:
1. the kind of goods and services offered;
 2. the estimated volume of business
 3. the location of the business
 4. estimated daily, monthly or annual net income.

Remark: For the purposes of determining a range of rates to apply to any particular trade or vocation, the Ministry of Finance, will so far as practicable, adopt the procedures set out in Regulation 77.2 of this Manual.

- 81.4 The Ministry of Finance will issue advice from time to time on the fixed taxes to be imposed on persons without a fixed place of business
- 81.5 Where no fixed tax is otherwise provided, persons in the following occupations pay each year a fixed tax equal to an amount as follows, written against an appropriate grade, in lieu of taxes on income from such occupations.

a. *Fresh Fruit Brokers

Grade I	Afs.	4,000
Grade II	Afs.	3,000
Grade III	Afs.	2,000
Grade IV	Afs.	1,500
Grade V	Afs.	500

**Decree Council of Ministers No. 998, Jawza 29, 1345*

b. Commercial Brokers and Buyers

*1 Commercial Brokers

Grade I	Afs.	3,000
Grade II	Afs.	2,000
Grade III	Afs.	1,000
Grade IV	Afs.	500
Grade V	Afs.	300

**Decree Council of Ministers No, 1753, Caus 18, 1343*

***2. Buyers of Wool, Skins, and Rugs**

Grade I	Afs.	5,000
Grade II	Afs.	4,000
Grade III	Afs.	3,000

**Decree of Council of Ministers No. 1753, Caus 18, 1343*

***3 Other Buyers**

Grade I	Afs.	3,000
Grade II	Afs.	1,500
Grade III	Afs.	1,000

**Decree of Council of Ministers No. 1753, Caus 18, 1343*

c. Auctioneers

1.	Kabul	Afs.	500
2.	Major Provincial cities	Afs.	400
3.	Local Government	Afs.	300

CHAPTER XII

**TAXATION RULES FOR
QUALIFYING EXTRACTIVE INDUSTRY TAXPAYERS**

Article 82 – Article 90

Definitions

Article 82.

(1) In this Chapter:

1. a "hydrocarbons Contract" means an Exploration Contract or Service Contract described in any applicable law affecting hydrocarbons in Afghanistan;
2. a "mining Authorization" means an Authorization described in Article 18 of the Minerals Law, 2005;
3. a "mining License" means a License described in Article 18 of the Minerals Law, 2005;
4. a "QEIT" means a Qualifying Extractive Industries Taxpayer and refers to a person that holds a mining License or mining Authorization or is party to a hydrocarbons Contract;
5. a "QEIT asset" is an asset that –
 - has an effective life greater than 12 months; and
 - is constructed or acquired to be used directly in the business subject to a mining License or mining Authorization or a hydrocarbons Contract.

- (2) A well that is drilled by a QEIT for the purpose of exploring for, developing, or producing hydrocarbons is deemed to be a QEIT asset and all costs incurred in the course of drilling the well, contracting with another person to drill the well for the QEIT, or closing a well are treated as the cost of acquiring the well. Where the drilling or contracting costs for drilling are incurred over more than one fiscal year, the QEIT is treated as acquiring separate QEIT assets in each year with a cost for each asset equal to the drilling or contracting costs for drilling incurred in that year.

82.1 Chapter XII of the Income Tax Law contains rules that apply to taxpayers known as Qualifying Extractive Industries Taxpayers. Subparagraph 4 of paragraph (1) of Article 82 defines a QEIT as a person that holds a mining License or mining Authorization or is party to a hydrocarbons Contract. The remaining Articles in Chapter XII apply only to a taxpayer that is a QEIT.

Article 82 also defines important concepts used in later Articles in the Chapter. Subparagraphs 1, 2, and 3 of paragraph (1) of Article 82 describe the types of rights that a taxpayer can hold in order to be considered a QEIT – a mining Authorization, a mining License, or a hydrocarbons Contract. These three terms are used throughout the Chapter.

- 82.2 A business that is involved in the extractive industries but which is not a QEIT as defined will not be entitled to use the provisions of Chapter XII.

Example: *Mining Support Services is a company which provides accommodation and meals to contractors and employees working on a copper mining site. The copper mine site is operated by Global Copper which holds a mining Authorisation. Only Global Copper will be entitled to use the provisions of Chapter XII. Mining Support Services, not being a QEIT, will be subject to the all the provisions of the income tax law except Chapter XII. Even though Mining Support Services is a business involved in the extractive industries, its business operations will be taxable on the same basis as for any other business in any other industry.*

- 82.3 Subparagraph 5 of paragraph (1) of Article 82 defines a QEIT asset. This definition is used in Article 86 which provides an accelerated depreciation rule for QEIT assets.

Paragraph (2) of Article 82 expands the definition of a QEIT asset to include all costs incurred by a QEIT in the course of drilling a well for the purpose of exploring for, developing, or producing hydrocarbons. The effect of this definition is to bring the cost of drilling a well into Article 86 so the cost will be deducted by way of depreciation deductions. The definition treats each year's costs as a separate QEIT asset, to be depreciated separately.

Precedence of Chapter XII

Article 83 The Articles in the Chapters of this Law apart from this Chapter apply to a QEIT in the same manner they apply to a taxpayer that is not a QEIT unless they are changed by an Article in this Chapter.

83.1 Chapter XII contains specific tax rules for what are known as "qualifying extractive industry taxpayers" – taxpayers that hold a mining License or mining Authorization or are party to a hydrocarbons Contract.

Chapter XII does *not* displace the remainder of the Income Tax Law for these taxpayers. A qualifying extractive industry taxpayer (or QEIT) is subject to the remainder of the Law in the same manner as all other taxpayers. The only effect of Chapter XII is to modify a limited number of general rules so they operate more appropriately to QEITs in recognition of some features of extractive industry investments that are not found in other commercial enterprises.

Article 83 makes it clear that all Articles of the Income Tax Law apply to QEITs in the same manner as they apply to other taxpayers unless there is an Article in Chapter XII that prescribes a different rule. In this case, the rule in Chapter XII takes precedence over the rule that would otherwise apply.

QEIT is treated as a separate taxpayer in respect of each Authorization, License, or Contract

Article 84.

- (1) If a QEIT is party to more than one hydrocarbon Contract or holds more than one mining License, or mining Authorization, or any combination of these, the person is treated as if it were a separate person in respect of the business operations related to each hydrocarbon Contract, mining License, or mining Authorization.
- (2) If a hydrocarbon Contract, mining License, or mining Authorization is renewed, the renewal is treated as part of the original hydrocarbon Contract, mining License, or mining Authorization for the purpose of this Article.
- (3) If a QEIT is party to more than one hydrocarbon Contract or holds more than one mining License, or mining Authorization, or any combination of these and incurs expenditure in relation to more than one hydrocarbon Contract, mining License, or mining Authorization, the expenditure is apportioned between the different parts of the business on the basis of the application of the expenditure.

84.1 To ensure the cost of acquiring an extractive industry asset is matched with the income produced by the asset, Article 84 treats each taxpayer as a separate person for each mining License, mining Authorization, or hydrocarbons Contract held by the taxpayer. As a result of this rule, a taxpayer cannot, for example, deduct expenses from developing a mine under one mining License against income derived from selling the output of a mine under another License held by the taxpayer. Instead, the cost of developing each mine will be deducted against the income derived from exploiting the mine.

If this rule were not used, a taxpayer that embarked upon a series of separate projects could avoid paying tax on income derived from the mature projects by starting a new project and deducting the expenses incurred on starting up the new project from the income derived from the mature projects that are already in production. By treating a taxpayer as a separate person in respect of each mining License, mining Authorization, or hydrocarbons Contract held by the person, the expenses incurred for each project will be matched to the income produced from the project.

Example: *Afghan Mining holds four Mining Licenses and Authorizations that cover two contiguous areas. In 2008, the company's operations in area 1 reached the production stage. The expenses and income from operations in area 2 in afghanis are as follows:*

<i>year</i>	<i>costs for that year</i>	<i>cumulative pre- production costs to the start of that year</i>	<i>sales</i>
2006	6 m	0 m	0
2007	6 m	6 m	100,000
2008	6 m	12 m	800,000
2009	4 m		8 m
2010	4 m		8 m
2011	4 m		8 m

As explained below in the description of Article 88, in 2008, the taxpayer can deduct its expenses for that year of 6 m (unless the expenses were incurred to acquire depreciable QEIT assets) and also deduct a portion of the 12 m pre-production costs incurred prior to 2008. The deductions allowed in 2008 for area 2 greatly exceed the income derived from area 2 in that year. However, as a result of Article 84, Afghan Mining cannot deduct the excess expenses from its income from area 1, which is mined under a separate mining Authorization. Instead, it will have a loss in 2008 in respect of area 2 and can carry the loss forward to deduct in later years against future income from the sale of minerals from area 2.

Business Receipts Tax

Article 85.

The Business Receipts Tax imposed under Chapter X of this Law does not apply to:

1. receipts of a QEIT from the sale of Mineral Substances (as defined in the Minerals Law, 2005) that are subject to a mining License or mining Authorization;
2. receipts of a QEIT from the sale of hydrocarbons that are subject to a hydrocarbons Contract; or
3. receipts of a QEIT from the sale or transfer of a mining License or mining Authorization or a hydrocarbons Contract.

85.1 The Business Receipts Tax imposed by Chapter X of the Income Tax Law is a turnover tax based on gross receipts of a business. The sale of Mineral Substances (as defined in the Minerals Law, 2005) is subject to royalties charges also imposed on the gross receipts from the sale. The rate of royalties imposed on gross receipts from the sale of minerals is determined on the basis that royalties will be the only charge imposed on the gross receipts. Article 85 exempts the receipts from Business Receipts Tax imposed under Chapter X of the Income Tax Law to ensure the royalties provisions in the Minerals Law, 2005 operate as intended and are the only charges imposed on the gross receipts from mineral sales.

85.2 Hydrocarbons are subject to a different licensing regime from the system applied to other mineral substances. The production of hydrocarbons is subject to royalties and "production sharing" agreements. As was the case with royalties imposed under the Minerals Law, the royalties regime and production sharing formula for hydrocarbons are calculated on the basis that there will be no additional tax based on gross sales. And again, as was the case with mineral sales, Article 85 exempts receipts from the sale of hydrocarbons from the Business Receipts Tax imposed under Chapter X of the Income Tax Law if the seller holds a contract for the conduct of hydrocarbon operations in Afghanistan. This ensures the hydrocarbons royalties and production sharing rules will operate as intended and there will be no further costs imposed on the gross production of hydrocarbons.

85.3 Article 85 also exempts the gross receipts from the sale or transfer of a mining License or mining Authorization or a hydrocarbons Contract from Business Receipts Tax.

85.4 Article 85 exempts three types of receipts from Business Receipts Tax but the exemption has no application to the income tax imposed on taxable income under Article 4. The taxable income of a taxpayer is a

measurement of net profits after deductions as allowed under the Income Tax Law.

Depreciation deductions

Article 86.

- (1) Contrary to paragraph 1 (7) of Article 18 of this Law, a person that is a QEIT and that incurs an expense to acquire a QEIT asset other than a building or rights to occupy a building may deduct the cost of acquiring the asset on a straight-line basis over the lesser of:
 1. the effective life of the asset; and
 2. five yearscommencing with a deduction in the year in which the asset is acquired.
- (2) Contrary to paragraph 1 (7) of Article 18 of this Law, a person that is a QEIT and that incurs an expense other than annual rent to construct or acquire a QEIT asset that is a building or to acquire rights to occupy a building may deduct the expense on a straight-line basis over 15 years, commencing with a deduction in the year in which the expense is incurred.
- (3) A person that is a QEIT that incurs an expense to acquire a mining Authorization or mining License or hydrocarbons Contract may deduct the cost of acquiring the Authorization, License or Contract on a straight-line basis over the period to which the Authorization, License or Contract applies.
- (4) The depreciated value of a QEIT asset at any time is the original cost less any deductions for the cost of constructing or acquiring the asset that were allowed under this Article. Where a person that is a QEIT disposes of a QEIT asset for more than its depreciated value, the excess of sale proceeds over depreciated value is included in the person's income for tax purposes. Where a person that is a QEIT disposes of a QEIT asset for less than its depreciated value, the excess of depreciated value over sale proceeds is deductible in the year of sale.

86.1 Where a taxpayer incurs a capital expense to acquire an asset with a life that lasts longer than the end of the fiscal year, no deduction is allowed for the cost of acquisition. By itself, the acquisition of an asset by a taxpayer does not result in any change in the net economic position of the taxpayer. Rather, it is merely a conversion of property from one form (most often money) to another form (tangible or intangible moveable property). As the property depreciates in value due to use or the passage of time, the taxpayer is allowed a deduction for the depreciation under paragraph 7 of subsection (1) of Article 18.

86.2 *Machinery and property other than buildings*

The rate of depreciation allowed under paragraph 7 of subsection (1) of Article 18 is set out in this Income Tax Manual and is based on the estimated life of the property. In the case of intangible property such as a contract or patent, the life of the property is known from the outset. In the

case of tangible property such as machinery or buildings, an estimate must be made of the life of the property. However, subsection (1) of Article 86 provides an "accelerated depreciation" rule that sets the maximum depreciation deduction period for all capital assets other than buildings or rights to occupy buildings at five years. The depreciation rate set out in subsection (1) of Article 86 is the *lesser* of five years and the effective life of the asset. If the asset has a life less than five years, the ordinary life is used. This could be the case, for example, with some quickly used small machinery or a contract for a few years. The cost is depreciated on a "straight-line" basis, meaning it is recognized in equal deductions over the life of the asset or the five year period if that applies.

Article 86 sets a maximum depreciation period for the cost of the asset and provides for straight-line depreciation. It does not replace paragraph 7 of subsection (1) of Article 18 and apart from the time period specified in Article 86, actual depreciation is calculated using the procedures set out in the Income Tax Manual for paragraph 7 of subsection (1) of Article 18. Thus, if a QEIT asset is acquired part way through a fiscal year, the procedures set out in the Income Tax Manual for paragraph 7 of subsection (1) of Article 18 will apply in the same manner as they would for other assets.

The accelerated depreciation deduction rules in paragraph (1) of Article 86 only apply to QEIT assets, which are defined in subparagraph 5 of paragraph (1) of Article 82 as assets constructed or acquired to be used directly in the business subject to a mining License or mining Authorization or a hydrocarbons Contract. Thus, if a company that had a quarry license to extract limestone also manufactured cement, the accelerated depreciation deduction rule would only apply to machines used in the quarry operation and not to machines used in the cement factory.

The phrase "used directly in the business subject to a mining License or mining Authorization or a hydrocarbons Contract" indicates that that a QEIT asset must actually be used in the process of carrying out the activity specified in a mining Authorization or License or a hydrocarbons Contract. This will be actual mining exploration or minerals extraction or actual hydrocarbon exploration or extraction.

It is assumed that assets used at a mining or hydrocarbons exploration or extraction site are applied directly to the activity specified in a mining Authorization or License or a hydrocarbons Contract. Assets used elsewhere will not be considered to be used in the process of carrying out the activity specified in a mining Authorization or License or a hydrocarbons Contract. Thus, assets used in an office of the taxpayer located in a city away from the mining or hydrocarbons operations will not be QEIT assets and the ordinary depreciation rules in paragraph 7 of subsection (1) of Article 18 will apply to these assets.

86.3 *Hydrocarbons Well*

Paragraph (2) of Article 82 deems a well that is drilled by a QEIT for the purpose of exploring for, developing, or producing hydrocarbons to be a QEIT asset and further treats all costs incurred in the course of drilling the well, contracting with another person to drill the well for the QEIT, or closing a well as the cost of acquiring the well. As a result, the cost of drilling a well will be the cost of a QEIT asset and can be deducted over the lesser of the expected life of the well and five years.

Only costs incurred in the actual drilling of a well, contracting with another person to drill a well for the QEIT, closing a well or acquiring a well are costs of a QEIT asset. Preparatory costs such as surveying or site preparation are not costs incurred in drilling a well and thus would not be costs incurred to acquire a QEIT asset. Those costs would not be recognized under Article 86, dealing with QEIT asset costs, and instead would be recognized under Article 88, dealing with pre-production costs.

86.4 *Buildings*

Assets that are subject to the depreciation rule in paragraph (1) of Article 86 do *not* include the cost of acquiring buildings or the right to occupy buildings that are QEIT assets. These are subject to the rule in paragraph 2 of Article 86. A QEIT asset is defined in paragraph 5 of subsection (1) of Article 82. A QEIT asset has two identifiable characteristics: it will have an effective life greater than 12 months; and it will have been constructed or acquired to be used directly in the business subject to a mining License or mining Authorization or a hydrocarbons Contract. If the QEIT asset is a building or a right to occupy a building, Article 86 rather than Article 18 will govern the maximum period for depreciation of the cost of acquisition or construction.

As is the case with assets other than buildings, it is assumed that buildings used at a mining or hydrocarbons exploration or extraction site are applied directly to the activity specified in a mining Authorization or License or a hydrocarbons Contract. Buildings used elsewhere will not be considered to be used in the process of carrying out the activity specified in a mining Authorization or License or a hydrocarbons Contract. Thus, an office building of the taxpayer located in a city away from the mining or hydrocarbons operations will not be a QEIT asset and the ordinary depreciation rules in paragraph 7 of subsection (1) of Article 18 will apply to the building.

Paragraph 2 of Article 86 applies to the cost of constructing or acquiring a building and the cost of acquiring a right to occupy a building other than the cost of annual rent. Ordinary rent is deductible as it is incurred. However, "pre-paid" rent for or a lump sum payment for a long-term lease would be treated as the equivalent as the cost of acquiring a building and subject to paragraph (2).

A single depreciation rule applies to the cost of constructing or acquiring buildings that are QEIT assets. These costs are depreciated on a straight-line basis (in equal annual deductions) over 15 years, subject to special rules for partial year depreciation in the year of acquisition. These are described in the Income Tax Manual for Article 18.

86.5 *Mining Authorization, Mining License, or Hydrocarbons Contract*

The cost of acquiring a mining Authorization, mining License, or hydrocarbons Contract (as these terms are defined in Article 82) is depreciable on a straight line basis (in equal annual deductions) over the life of the rights acquired. The cost of acquiring a mining Authorization, mining License, or hydrocarbons Contract includes all incidental costs such as legal fees and other indirect expenses that led to the acquisition of the mining Authorization, mining License, or hydrocarbons Contract. As these expenses are part of the cost of acquisition, under subparagraph 1 of paragraph (2) of Article 19 they may not be deducted under another provision but must be recognized under the depreciation rules.

86.6 *Balancing adjustment on disposal of QEIT asset*

When a QEIT sells an asset that is depreciated under Article 86, there will be a balancing adjustment if the sale proceeds are greater or lesser than the asset's "depreciated value" at that time. The depreciated value is the original cost less any depreciation deductions that were previously taken. If the sale proceeds exceed the depreciated value, previous deductions proved to be excessive and the excess deductions are "recaptured" by way of an income inclusion. The excess of sale proceeds over depreciated value is included in income. If the sale proceeds are less than the depreciated value, previous deductions proved to be insufficient and the shortfall is recognized by way of a further deduction. The excess of depreciated value over the sale proceeds is allowed as a deduction.

If a QEIT sells all its rights in a project, including its rights to the original license and all its equipment and buildings, the seller and the buyer will be required to allocate the sale price between the different types of property transferred so the provisions of Article 86 can be applied by the seller and the purchaser. The price must be allocated on the basis of the market value of the different assets sold.

Cost of constructing roads

Article 87.

- (1) This Article applies to a person that is a QEIT and that incurs an expense to construct a road that will be used to carry on a business that is subject to a mining License or mining Authorization or a hydrocarbons Contract.
- (2) A person described in paragraph (1) of this Article may deduct the cost of constructing the road described in paragraph (1) of this Article over a period of fifteen years commencing with a deduction in the year in which the road is completed.
- (3) This paragraph applies where a person that is a QEIT sells its rights under a mining License or mining Authorization or hydrocarbons Contract to another person and as a result of that transfer the person making the sale will no longer use a road described in paragraph (1) of this Article and the person acquiring the mining License, mining Authorization or hydrocarbons will use the road. In this situation, the person acquiring the mining License, mining Authorization or hydrocarbons Contract asset is entitled to deduct the undeducted cost of constructing the road over the remaining deduction years. For this purpose, the remaining deduction years for the road is calculated as 15 minus the number of years during which the previous owner or owners were entitled to deductions under this Article.
- (4) Where paragraph (3) of this Article applies to a road described in paragraph (1) of this Article, the person who sells its rights under a mining License, mining Authorization or hydrocarbons Contract is not entitled to any deductions under this Article for the cost of constructing the road the year in which the rights under the mining License, mining Authorization or hydrocarbons Contract are sold or in any later year.

87.1 It is common for mining or hydrocarbon projects to be located in areas that are not accessible using existing roads. In this case, the QEIT with a hydrocarbons Contract, mining Authorization or mining License will have to construct roads to gain access to the site. The QEIT has rights to use immovable property and to extract minerals or hydrocarbons from the property, but does not have any ownership of the underlying property. The roads, therefore, will revert to the owner of the immovable property at the end of the contract or license. Normally it is the owner of property that is allowed depreciation deductions under Article 18. However, Article 87 extends depreciation rights to the QEIT that has incurred costs to construct a road used for a QEIT project.

87.2 Subsection (2) of Article 87 sets out a 15 year depreciation period. Depreciation is allowed on a straight-line basis and the ordinary depreciation rules in paragraph 7 of subsection (1) of Article 18 apply. However, since Article 87 provides for deductions "over a period of fifteen years commencing with a deduction in the year in which the road is completed" the rule in Article 18 that applies to acquisitions part way

through a tax year does not apply. An eligible QEIT can deduct 1/15 of the cost of constructing a road in the year in which the road is completed. Apart from the time period specified in Article 87, depreciation is calculated using the procedures set out in the Income Tax Manual for paragraph 7 of subsection (1) of Article 18.

- 87.3 The depreciation period is fixed from the year in which the road is completed. If one QEIT sells its rights in a natural resource exploitation project to another QEIT, under subsection (3) of Article 87, the original period continues and the new owner is entitled to depreciation deductions for the remaining period of the original 15 years.
- 87.4 Subsection (4) makes it clear that following the sale of a natural resource project, including rights to use any road constructed for the project, the seller is not entitled to further deductions for the construction of the road and only the purchaser is entitled to those deductions.

Example: *Afghan Minerals is a foreign-owned company. It applied for permission under Article 3 of this Law to use a substituted fiscal year based on the European calendar running from 1 January to 31 December. Permission was granted.*

In November 2006, Afghan Minerals commenced work on a copper mine, including an access road from the Kabul-Herat Road to the mining site. The road cost 300,000 afghanis to construct. It was completed at the end of June 2007. In 2007 and in each of the following 14 years, Afghan Minerals is allowed to deduct $1/15 \times 300,000 = 20,000$ afghanis.

In 2012, Afghan Minerals sold its mining operations to New Mining Company for 5 million afghanis. At that time, Afghan Minerals had deducted 100,000 in years 2007-2011. Of the 5 million that New Mining Company paid for the entire operation of Afghan Minerals, $(300,000 - 100,000) = 200,000$ afghanis is presumed to have been paid for all rights related to the road. The cost of all the other assets and rights acquired is thus 4,800,000 afghanis. New Mining Company is able to deduct 20,000 afghanis in 2012 and in each of the following 9 years.

Pre-production costs

Article 88.

- (1) Notwithstanding Article 18 of this Law, a person that is a QEIT may only deduct an expenditure that is a pre-production cost on a straight-line basis over the pre-production cost recovery period where –
1. a "pre-production cost" is any expenditure that is incurred by a QEIT prior to commencing commercial production of minerals in the course of business related to a mining License or mining Authorization or a hydrocarbons Contract. However, a pre-production cost does not include the cost of acquiring a QEIT asset or the cost of constructing a road;
 2. the "pre-production cost recovery period" for a mining business carried on by a QEIT in an area defined in a mining License or mining Authorization is the lesser of –
 - 15 years; and
 - the number of years remaining in the License or Authorization
 3. the "pre-production cost recovery period" for a hydrocarbon business is the number of years remaining in the Contract.
- (2) A QEIT is treated as commencing commercial production of minerals or hydrocarbons in the earlier of:
1. the year in which the Ministry of Finance and the Ministry of Mines and Industries issue to the QEIT a written notification that the Ministries jointly accept a written submission by a QEIT that it has commenced commercial production,
 2. in the case of a QEIT that holds a mining Authorization, the year in which the proceeds from the sale of minerals exceeds 6 percent of the pre-production costs incurred by the QEIT prior to that year, or
 3. in the case of a QEIT that holds a hydrocarbons Contract, the year in which the proceeds from the sale of hydrocarbons exceeds the threshold percentage of the pre-production costs incurred by the QEIT prior to that year where the number in the threshold percentage is determined by dividing 100 by the number of years of the hydrocarbons Contract.
- (3) Where a person that is a QEIT sells its rights in a mining License or mining Authorization or hydrocarbon Contract to another QEIT, the first QEIT may add to the cost of acquiring its rights in the License, Authorization or Contract any pre-production expenses it incurred that have not been previously deducted under paragraph (1).

- 88.1 Article 88 explains how a QEIT can recognize pre-production costs for tax purposes. Pre-production costs are defined in paragraph 1 of subsection (1) of Article 88. These are any expenses incurred by a QEIT prior to commencing commercial production of minerals related to a mining License or mining Authorization or a hydrocarbons Contract other than the cost of acquiring QEIT assets (which are depreciated under Article 86) or constructing a road (which are depreciated under Article 87).
- 88.2 Pre-production costs are considered to be a type of "capital expense" incurred by a QEIT in the acquisition of an asset, namely an operative mine or hydrocarbon well. Article 88 requires the QEIT to keep record of all pre-production costs and then allows the QEIT to depreciate the costs over what is known as the "pre-production cost recovery period". This is defined in paragraph 2 of subsection (1) of Article 88 as the lesser of 15 years and the number of years remaining in the License or Authorization for a mining project and in paragraph 3 of subsection (1) of Article 88 as the number of years remaining in a hydrocarbon Contract in the case of a hydrocarbon project. The number of years remaining in a mining License, mining Authorization or hydrocarbons Contract is calculated from the beginning of the year in which commercial production commences.

Example: *Afghan Mining commences operations in 2006. It has a 20 year mining Authorization. Afghan Mining incurs substantial pre-production expenses from 2006 to 2008. In 2009, it commences commercial production (according to the formula in paragraph 2 of subsection (2) of Article 88). There are 17 years remaining in the mining Authorization. The deduction period in paragraph 2 of subsection (1) of Article 88 is thus 15 years. Afghan Mining may deduct 1/15 of its pre-production costs in 2009 and for each of the following 14 years.*

- 88.3 The rule in Article 88 only applies to "pre-production costs" which are defined in paragraph 1 of subsection (1) of Article 88 as expenses incurred prior to commencing commercial production. The time at which a QEIT will be considered to have commenced commercial production is defined in subsection (2) of Article 88. It is the earlier of the year in which the Ministry of Finance and the Ministry of Mines and Industries issue to the QEIT a written notification that the Ministries jointly accept a written submission by a QEIT that it has commenced commercial production and a production threshold. Different production thresholds apply to hydrocarbon and mineral QEITs. In the case of a minerals QEIT, the production threshold is set out in paragraph 2 of subsection (2) of Article 88. A minerals QEIT will be treated as meeting the production threshold in the year in which the proceeds from the sale of minerals exceeds 6 percent of the pre-production costs incurred by the QEIT prior to that year.

Example: *Afghan Minerals has a mining Authorisation and commences to establish a coal mine in 2006. Afghan Minerals incurs annual expenses of 6 million afghanis over three years and 4 million afghanis in subsequent years. In 2009 it began limited sales and started full production in 2011. Its sales and expenses in afghanis are as follows:*

<i>year</i>	<i>costs for that year</i>	<i>cumulative pre-production costs to the start of that year</i>	<i>sales</i>
2006	6 m	0 m	0
2007	6 m	6 m	100,000
2008	6 m	12 m	800,000
2009	4 m		8 m
2010	4 m		8 m
2011	4 m		8 m

In 2007, sales amounted to $100,000/6,000,000 = 1.6\%$ of prior cumulative pre-production costs.

In 2008, sales amounted to $800,000/12,000,000 = 6.6\%$ of prior cumulative pre-production costs. As a result, the QEIT can begin depreciating the \$12 m of pre-production costs in 2008. Expenses incurred in 2008 will not be pre-production costs. Their treatment will depend on the nature of the costs. If they are costs incurred to acquire QEIT assets, the QEIT asset depreciation rules will apply to them. If they are production costs that do not involve the acquisition of QEIT assets they can be deducted in that year.

- 88.4 In the case of a hydrocarbons QEIT, the year in which the production threshold will have been met is described in paragraph 3 of subsection (2) of Article 88. For a QEIT that holds a hydrocarbons Contract, this is defined as the year in which the proceeds from the sale of hydrocarbons exceeds the threshold percentage of pre-production costs where the threshold percentage is determined by dividing 100 by the number of years of the hydrocarbons Contract.

Example: *PetroAfghan has a 10 year production license under a hydrocarbons contract. It incurs drilling costs and operating costs in afghanis as follows:*

<i>year</i>	<i>costs for that year</i>	<i>cumulative pre- production costs to the start of that year</i>	<i>sales</i>
2006	6 m	0 m	0
2007	6 m	6 m	100,000
2008	9 m	12 m	800,000
2009	1 m	21 m	4 m
2010	1 m		4 m
2011	1 m		4 m

The production threshold for PetroAfghan is determined as $10/100 = 10\%$. The year in which sales exceed 10% of pre-production costs incurred prior to that year, the QEIT may commence to depreciate the pre-production costs.

In 2007, sales amounted to $100,000/6,000,000 = 1.6\%$ of prior cumulative pre-production costs.

In 2008, sales amounted to $800,000/12,000,000 = 6.6\%$ of prior cumulative pre-production costs.

In 2009, sales amounted to $4,000,000/21,000,000 = 19\%$ of prior cumulative pre-production costs. The remaining time on the contract (including the year of qualification) is 7 years. The taxpayer can therefore depreciate \$21,000,000 over 7 years which equals \$3,000,000 per year. The treatment of the \$1 million incurred in 2009 will depend on whether the expenses were for QEIT assets (and therefore depreciable) or for expenses that were consumed in the year (and therefore deductible).

- 88.5 Subsection (3) of Article 88 explains what happens if a QEIT sells its rights in a mining License or mining Authorization or hydrocarbon Contract to another QEIT. At the time it sells its rights, it may have deducted all the pre-production costs incurred. It can add the undeducted costs to the cost of its rights when calculating the gain or loss on the sale of the rights.

Example: *Consider the example of PetroAfghan immediately above if PetroAfghan had sold its rights under its hydrocarbons Contract to NewCo in 2010 for 25 million afghanis. At that point, PetroAfghan will have deducted 3,000,000 of its 21,000,000 afghanis pre-production costs. It has not deducted 18,000,000 afghanis of the pre-production costs. Under subsection (3) of Article 88, PetroAfghan can treat the excess of its pre-production costs over the portion previously deducted as costs of acquiring the Contract rights. When it sells its rights to NewCo, it will have a gain of $25,000,000$ minus $18,000,000 = 7,000,000$ afghanis profit on the sale.*

The first QEIT may add to the cost of acquiring its rights in the License, Authorization or Contract any pre-production expenses it incurred that have not been previously deducted under paragraph (1).

Deduction for contributions to a fund for environmental and social obligations

Article 89

A person that is a QEIT may deduct any amount that is required to be paid in respect of environmental and social obligations under Article 82 of the Minerals Law, 2005 or pursuant to a plan required by any applicable law affecting hydrocarbons provided –

1. the amount is paid to an entity that has no direct or indirect connection to the person claiming a deduction under this Article; and
2. the person provides, through a financial institution approved for this purpose by the Da Afghanistan Bank, a bank guarantee for payment to the Ministry of Finance of the deductible amount in the event the entity holding the amount deposited does not apply the funds as specified in the governing Minerals Regulations or pursuant to a plan required by any applicable law affecting hydrocarbons.

89.1 Under normal circumstances, payments to a fund for future environmental or social obligations would not give rise to a deduction as the payment would be treated as a provision or reserve (in effect, an amount set aside for future expenditure) with a deduction available only when amounts are spent on actual environmental or social purposes related to the original QEIT operations. However, Article 89 allows a deduction for contributions to a fund for environmental and social obligations of a QEIT where the QEIT has completely severed its power to control the use of the money paid to the fund.

The subsection contains two conditions that must be met to ensure the QEIT has truly given up all control over the money and further that the money is guaranteed to be available for the intended purpose. The first condition is that the environmental or social fund must be under the control of another entity that has no direct or indirect connection to the person claiming a deduction under Article 89. Second, the QEIT making the contribution must provide the Ministry of Finance with a bank guarantee for payment of the amount deducted in the event the entity holding the amount deposited does not apply the funds as specified in the governing Minerals Regulations or pursuant to a plan required by any applicable law affecting hydrocarbons.

89.2 A bank guarantee imposes an obligation on the financial institution that issues the guarantee to make a payment of the amount that should have been applied by the fund for environmental or social purposes. It is an absolute promise by a financial institution to make a payment upon presentation by the Ministry of Finance of evidence showing the entity holding funds to be used for environmental or social purposes did not apply the funds as specified in the governing Minerals Regulations or pursuant to a plan required by any applicable law affecting hydrocarbons. A bank guarantee will only satisfy the requirements of Article 89 if the

financial institution issuing the bank guarantee has been approved for this purpose by the Da Afghanistan Bank.

- 89.3 It is a requirement for the deduction that the environmental or social fund to which money is contributed must be under the control of another entity that has no direct or indirect connection to the QEIT claiming the deduction. This requirement is intended to ensure that the QEIT that claimed a deduction cannot later access the funds for its own purposes. It may be the case, however, that despite the assurances given, the QEIT claiming the deduction has a connection with the entity controlling the fund or has influence over that entity and as a result amounts from the fund are later passed directly or indirectly back to the QEIT that claimed the deduction or to an entity connected with the QEIT that claimed the deduction. Amounts would be considered to be passed indirectly back to the QEIT where the money is spent for the benefit of the QEIT that claimed the deduction or for the benefit of another entity that is connected to the QEIT who claimed the deduction. In these cases, the amount that passed directly or indirectly back to the QEIT who claimed the deduction would be treated for tax purposes as income of the QEIT.
- 89.4 In the ordinary course of events where a QEIT pays an amount into a social or environmental fund and the money is later applied by the fund for the purposes specified in the Mining Regulations or pursuant to a plan required by any applicable law affecting hydrocarbons, the money in the fund will have been completely severed from the company that contributed it. The use of the money by the fund will have no connection to the QEIT that originally contributed it and the spending of the money has no effect on the tax liability of the QEIT.

Loss carry-forward and stability agreements

Article 90

- (1) Article 42 of this Law, which imposes a limit on the recognition of net operating losses, does not apply to a QEIT. Where a QEIT incurs a net operating loss as defined in Article 47, the loss may be treated as a deductible expense in the following year.
- (2) Subject to paragraph (3) of this Article, the Ministry of Finance shall apply to a QEIT the provisions of this Law as they stood at the time the QEIT became party to a mining Authorization, mining License, or hydrocarbons Contract for a period of:
 1. 5 years, in the case of a QEIT holding a mining Authorization, commencing in the year in which the QEIT begins to hold the Authorization;
 2. 8 years, in the case of a QEIT holding a mining License, commencing in the year in which the QEIT begins to hold the License; or
 3. the period of the hydrocarbons Contract, in the case of a QEIT that is party to a hydrocarbons Contract.
- (3) The Ministry of Finance shall only apply the provisions of this Law to a QEIT as set out in paragraph (2) where the QEIT has agreed in writing that taxable income of the QEIT shall be subject to an income tax rate of 30% for the years in which the provisions of this Law are applied by the Ministry of Finance on the basis of this Article without regard to subsequent changes.

90.1 *Loss carry forward*

Article 42 provides a loss carry-forward rule for taxpayers incurring a net operating loss. As a result of subsection (1) of Article 90, the rule in Article 42 will not apply to a taxpayer that is a QEIT. The loss carry-forward rule in Article 42 allows taxpayers that incur a net operating loss in a year to deduct one-third of the loss in each of the following three years. The rule in subsection (1) of Article 90 allows a QEIT that has incurred a loss to deduct the entire loss in the following fiscal year. If the deduction in a later year leads to a loss in that later year, that loss, too, may be carried forward to the next year. The effect is to allow indefinite carry-forward for net operating losses.

90.2 *Stability*

Subsection (2) of Article 90 provides entities that hold a mining Authorization, mining License, or hydrocarbons Contract with a "tax stability" guarantee. This is an assurance that the tax law in effect at the time they became a party to the mining Authorization, mining License, or hydrocarbons Contract will continue to apply to them for the time set out

in the subsection. This stability guarantee allows entities in long-term natural resource extraction projects to invest on the basis of certainty as to all the tax rules and tax rates that will apply to profits from the project for the period set out in the subsection. In other words, the entire Income Tax Law, including all administrative, rate and other provisions, in effect at the time the QEIT became a party to the mining Authorization, mining License, or hydrocarbons Contract will continue to apply to them for the time set out in the subsection. The tax stability period is 5 years, in the case of a QEIT holding a mining Authorization, 8 years, in the case of a QEIT holding a mining License, and the period of the hydrocarbons Contract, in the case of a QEIT that is party to a hydrocarbons Contract. The stability period runs from the year in which the QEIT begins to hold the mining License, mining Authorization or hydrocarbons contract, as the case may be.

To qualify for application of the tax stability rule in subsection (2), the QEIT must agree in writing that the tax rate applied to the taxpayer will be 30% instead of the rate that would otherwise apply. The tax stability agreement must be entered into at the same time as the mining Authorization, mining License, or hydrocarbons Contract to which it relates.

As a tax stability agreement is entered into at same time as the mining Authorization, mining License, or hydrocarbons Contract to which it relates, a QEIT who has more than one Authorization, License or Contract will have more than one stability agreement, assuming the QEIT has signed stability agreements for the different Authorizations, Licenses or Contracts. As a result of Article 84, a QEIT that holds more than one Authorization, License or Contract will be treated as a separate taxpayer in respect of each Authorization, License or Contract it holds.

A QEIT that holds more than one Authorization, License or Contract may have some expenses common to two or more Authorizations, Licenses or Contracts. For example, a QEIT may have a head office in Kabul and hold Contracts for two separate drilling areas in other provinces. The assets in Kabul cannot be QEIT assets as they are not used directly in the drilling and hydrocarbon extraction process. Similarly, expenses incurred for operations in Kabul cannot be pre-production expenses. The costs of assets in the Kabul office and other expenses are subject to the ordinary provisions of the Income Tax Law, not Chapter XII. As a separate stability agreement will apply to each Contract, the agreements will have no effect on the separate application of the Income Tax Law to the operations in Kabul.

CHAPTER XIII

ASSESSMENT, RETURNS, OBJECTIONS AND PAYMENT OF TAX

Article 91 - Article 96

Tax Identification Number

- Article 91 (1) Individuals, companies and organizations which are, according to the Income Tax Law and the Customs Law, required to pay taxes or customs duties; social, non profit and welfare organizations which are required to withhold taxes from the salaries or wages of their employees; persons who have an account or open an account with a bank or other financial institution; and employees whose incomes are subject to income tax withholding under provisions of this Law are required to have a Tax Identification Number.
- (2) Procedures for the issue and use of Taxpayer Identification Numbers will be prepared by the Ministry of Finance.
- (3) Ministries, government agencies and other government organizations shall not issue or renew business licenses for natural or legal persons who are required to have a Tax Identification Number but fail to provide it.

91.1 Individuals, companies and organizations that are required to pay taxes or customs duties are required to have a taxpayer identification number.

Example 1: *Wahid is an employee of a Non-Governmental Organization. Wahid earns Afs. 10,000 per month. Wahid does not have any other income. Wahid is not subject to income tax under Article 4. Wahid does not have to obtain a taxpayer identification number.*

Example 2: *Wahid is an employee of a Non-Governmental Organization. Wahid earns Afs. 30,000 per month. Wahid is subject to tax under Article 4. Wahid must obtain a taxpayer identification number because he is subject to tax. The Non-Governmental Organization must also obtain a taxpayer identification number because it is obliged to withhold tax from Wahid's wages.*

Example 3: *Company A is an Afghan corporation that has generated losses every year that it has operated. Although Company A has generated losses, it is still required to pay Business Receipts Tax. Hence, Company A is required to obtain a taxpayer identification number.*

Example 4: *Company B is an Afghan corporation that is engaged in construction work in Herat. During its first year of operation, Company B imported goods that were subject to customs duty. Company B did not have any revenue in its first year of operation. Company B did not have any profit during its first year of operation. Even though Company B does not have to pay income tax or Business Receipts Tax during its first year of operation, it must obtain a taxpayer identification number, because it paid customs duties.*

91.2 Non-profit and welfare organizations that withhold taxes from the salaries or wages of their employees must obtain taxpayer identification numbers.

Example 1: *A non-governmental organization employs a single Afghan individual. The organization pays the employee Afs. 10,000 per month. The organization does not have any other employees. The organization does not have to withhold any portion of the employee's wages under Article 46(1). Thus, the organization does not have to obtain a taxpayer identification number.*

Example 2: *A non-governmental organization employs two Afghan citizens. One Afghan citizen earns Afs. 20,000 per month. The other Afghan citizen earns Afs. 10,000 per month. The non-governmental organization is required to file an application to obtain a taxpayer identification number.*

91.3 Individuals who have an account with a bank must obtain a taxpayer identification number.

Example: *Najibullah opens a bank account in the name of his child, Azziz. Azziz is only 10 years old, but Najibullah wants Azziz to learn how to save money. Najibullah deposits Afs. 100 in the account. Azziz must obtain a taxpayer identification number.*

91.4 To obtain a taxpayer identification number, the taxpayer should request a Tax Identification Number application form from the Ministry of Finance or at a mustofiat office which has a TIN office co-located on the premises. The Ministry of Finance's Tax Information Page at www.mof.gov.af/tax has application forms that can be downloaded, completed and submitted to the Ministry of Finance.

Assessments and amended assessments

- Article 92
- (1) Persons who are subject to income tax under the provisions of this Law are required to file a detailed return to report income, deductions, tax withholding, and other necessary information required by the provisions of this Law and the income tax manual and submit it to the relevant tax office.
 - (2) An individual who derives wage income that is subject to income tax withholding in accordance with the provisions of this Law shall not make a return unless the person receives wages from two or more employers or the person has other income in addition to his wage income. The withheld tax from wages and salaries under the provision of the Law is not refundable.
 - (3) Where a person has delivered a tax return form required under the provisions of this Law, the tax due if any according to the tax return shall be treated as an assessment of tax payable and the return shall be treated as a notice of assessment.
 - (4) Where the Ministry of Finance believes that the information provided on a tax return does not correctly disclose the tax due, the Ministry of Finance may determine the amount of the tax due and issue to the person liable for payment of the tax an amended assessment notice for the amount due. This notice may also be amended if the Ministry of Finance believes it does not correctly show the tax due. The amended notice is treated as a notice of assessment.
 - (5) Where a person has not prepared and delivered a tax return required under provisions of this Law, the Ministry of Finance may determine the amount of tax due and issue to the person liable for payment of the tax a notice of assessment for the amount due. This notice may be amended if the Ministry of Finance believes it does not correctly show the tax due. The amended notice is treated as a notice of assessment.
 - (6) The Ministry of Finance may issue an assessment notice or amend an assessment notice only within five years of the date on which the tax return to which the notice relates was due. However, the Ministry of Finance may make or amend an assessment at any time where a person failed to deliver a tax return or delivered an incorrect tax return with the intent of evading tax.
 - (7) Where the Ministry of Finance believes that the collection of tax that will become due is in jeopardy because a person is about to depart from Afghanistan, to cease business, or to transfer property, or for other reasons, the Ministry of Finance may at any time issue an assessment notice for any period in the current or preceding tax year.

92.1 Legal persons formed under the laws of Afghanistan are required to file an income tax return whether or not they have income during the year.

Example 1: *Company A is an Afghan corporation that generated Afs. 10,000 of profit during the year 1385. Company A must file an income tax return for the year 1385.*

Example 2: *Company B is an Afghan corporation that generated a Afs. 10,000 loss during the year 1385. Company B must file an income tax return for the year 1385 even though it does not have a tax liability in that year.*

Example 3: *Company C is a partnership formed under the laws of Afghanistan. Company C must file an information return every year, regardless whether the partnership generates profit or loss.*

92.2 Natural persons are required to file an income tax return. There are two exceptions, however.

(a) The first exception applies if a natural person meets the following requirements:

1. The individual is employed by a single employer.
2. The employer properly withholds tax from the individual's wages.
3. The individual does not have any other source of income.

Example: *Naim is employed by the Ministry of Finance. Naim earns Afs. 20,000 per month in salary. Naim has no other source of income. Naim is subject to tax under Article 4, but the Ministry of Finance withholds tax from Naim's wages. Naim does not have to file an income tax return.*

(b) The second exception applies if the natural person is not subject to income tax.

Example: *Baz is employed by the Ministry of Finance. Baz earns Afs. 10,000 per month in salary. Baz has no other source of income. Because Baz is not subject to tax under Article 4, Baz does not have to file an income tax return under this Article.*

92.3 Taxpayers that are subject to income tax under the Income Tax Law, but are exempt from tax due to an international agreement or treaty, must file an income tax return. The income tax return should reflect the effect of the exemption. The relevant agreement or portion of the treaty should be attached to the tax return with an explanation as to why the agreement or treaty applies.

Example: *Company A is an Afghan corporation that provides construction services to the Ministry of Education. Company A operates under an agreement that the Government of Afghanistan has with a foreign sovereign government. The agreement was duly entered into by the*

Government of Afghanistan. The agreement exempts the Contractor's activities from Afghan taxation. The contractor must file an income tax return in Afghanistan. The tax return should reflect the fact that the contractor does not owe any tax. The relevant portions of the agreement should be attached to the taxpayer's tax return.

92.4 Taxpayers can obtain tax forms from Ministry of Finance tax offices (including mustufiats) and from authorized banks. Guides to help with the completion of tax forms can be downloaded from the Ministry of Finance website at www.mof.gov.af/tax. Instructions on the form will direct the taxpayer where the form should be filed.

92.5 If a taxpayer completes and files a tax return on a timely basis, the tax return shall constitute a notice of assessment. There are then three possibilities:

- (a) If the Afghanistan Revenue Department believes that the tax return was properly filed, and the tax due was properly remitted, no further action is necessary.
- (b) If the taxpayer properly completed and filed its return, but the taxpayer did not remit sufficient funds to the Ministry of Finance to satisfy the amount due, the Ministry of Finance may, at its option, seek to collect from the taxpayer the amount shown as due on the tax return.

Example: *Company A is an Afghan corporation that properly completes and files a tax return. The return shows that Company A owes Afs. 100,000. Company A does not remit any money with the return. The Afghanistan Revenue Department, upon examining the return and discussing the matter with the taxpayer, believes that the return was properly completed and that it is accurate. The Ministry of Finance may immediately begin collection procedures under Chapter XIV of this Income Tax Law.*

- (c) If the Afghanistan Revenue Department believes, after due examination and investigation, that the tax return was improperly completed, then the Afghanistan Revenue Department has five years from the date on which the tax return was due (except where the Afghanistan Revenue Department considers the return was filed with the intent of evading tax) to issue an amended notice of assessment to the taxpayer. The amended notice should indicate the amount that the Afghanistan Revenue Department believes the taxpayer owes.

92.6 If the taxpayer has not filed a tax return that is due, the Afghanistan Revenue Department has the authority to issue a tax assessment for the taxpayer following these steps:

- (a) The Afghanistan Revenue Department should request, in writing, that the taxpayer file its tax return within a reasonable time.

- (b) If the taxpayer requests additional time to file its tax return, the Afghanistan Revenue Department may grant additional time in its sole discretion. If the tax return is subsequently filed, the Afghanistan Revenue Department should consider whether any potential penalties should be assessed under its authority in Chapter XVI.
 - (c) The Afghanistan Revenue Department should prepare an assessment after it has made reasonable inquiries. In particular, the Afghanistan Revenue Department should attempt to obtain any information that would be relevant to determining the appropriate amount of tax due. For example, to determine the amount of business receipts tax due, the Afghanistan Revenue Department may request that the taxpayer provide all of its sales receipts for the past year. If inadequate information is available, the Afghanistan Revenue Department should seek to estimate the taxpayer's liability by looking at the tax liability owed by similar taxpayers under similar conditions or arrive at an estimated assessment for the taxpayer in question by other means appropriate to the situation.
 - (d) Once the assessment is complete, the Afghanistan Revenue Department should deliver a completed notice of assessment to the taxpayer. If the taxpayer does not pay the tax immediately, enforcement actions may be taken in accord with Chapter XIV.
- 92.7 If the taxpayer filed its tax return on time, but the Afghanistan Revenue Department believes that it should issue an amended assessment to the taxpayer, the Afghanistan Revenue Department must send the assessment notice to the taxpayer within 5 years of the date that the tax return was due (except where the Afghanistan Revenue Department considers the return was filed with the intent of evading tax). An assessment will be considered "sent" on the day that it is delivered to the taxpayer or to a reliable document delivery service. A document delivery service will be deemed to be "reliable" if it requires the signature of the recipient and the Afghanistan Revenue Department can establish that the signature was actually obtained. In all other cases, whether a document delivery service is considered "reliable" will depend on the relevant facts and circumstances.
- 92.8 If a taxpayer files a tax return, but does not file the return on time, the Afghanistan Revenue Department may (if it chooses to) issue a notice of assessment within five (5) years of the date the tax return was due to be submitted to the relevant tax office (except where the Afghanistan Revenue Department considers the return was filed with the intent of evading tax).
- 92.9 If a taxpayer does not file a tax return, the Afghanistan Revenue Department may (if it chooses to) issue a notice of assessment when it chooses to do so. The Afghanistan Revenue Department is not bound by the five year time limit in the case of taxpayers that do not file a tax return.

92.10 Despite the foregoing rules, the Afghanistan Revenue Department may issue an assessment to a taxpayer before the tax return is due or without giving reasonable time for a taxpayer to submit a tax return (a “jeopardy assessment”) if all three of the following conditions are satisfied:

- (a) The Afghanistan Revenue Department has collected evidence that suggests that it is more likely than not that the taxpayer has an unpaid tax liability.
- (b) The Afghanistan Revenue Department has evidence that suggests that it is more likely than not that any one of the following events will soon occur:
 - (i) The taxpayer will cease doing business.
 - (ii) Assets that could be used to pay the tax will be transferred outside of Afghanistan.
 - (iii) Key individuals (e.g., directors or officers of a company) are about to leave the country.
- (c) The Afghanistan Revenue Department has evidence which suggests that it is more likely than not that the unpaid tax liability will not be paid unless a jeopardy assessment is issued.

Submitting Returns and Payment of Tax

- Article 93
- (1) A person who is required to complete a tax return other than a business receipts tax form must submit their tax return by the end of Jawza (third month) of the next year to the relevant tax office.
 - (2) Tax specified in an assessment notice is payable on the date specified in the assessment notice.
 - (3) Residents and non-residents who intend to leave the country before the due date for payment of their tax are required to submit their return form and pay the tax due two weeks before leaving the country.
 - (4) Income tax payable by persons required to submit a tax return according to the provisions of this Law that is not subject to other payment regulations under this Law must be paid when the tax return is submitted.
 - (5) A person required to complete a business receipts tax form must complete a tax form for each quarter year. The person must deliver the form and the tax payable for the quarter no later than the fifteenth day of the next month after each quarter year. A business receipts tax form must be delivered by each person who operates a business, regardless of whether or not in one or more months of the fiscal year the person has derived income below the threshold provided in paragraph 1 (6) of Article 65 of this Law.
 - (6) Unless a different time is provided in this Law, persons who carry on business from fixed business establishments are required to pay their due tax quarterly and the payment for each quarter shall be made no later than the fifteenth day of the month following each quarter.
 - (7) Persons who own movable and immovable property shall pay tax due at the time ownership of such property is transferred.
 - (8) Tax on contracts signed with government agencies, according to Article 73 of this Law, shall be withheld at the time payment is made by the relevant government agency.
 - (9) Income tax on the gains by brokers shall be paid no later than five days after the end of the tax year.
 - (10) The income tax on shows, exhibitions, theaters, cinemas, concerts, sports and similar events shall be paid no later than the fifteenth day of the next month. If the mentioned shows are not continuous, tax shall be paid after the end of each show.

93.1 Article 3(1) provides that the tax year begins on the first day of Hamal and ends on the last day of Hoot. The tax return for the year ending on the last day of Hoot is not due until the last day of Jawza.

If according to the tax return no tax is payable (e.g. the taxpayer has a tax loss, has no income, or all his income is exempt from tax), the tax return should be submitted to the nearest tax office (or given to a reliable mail delivery service or courier for delivery to a tax office) by the last day of Jawza.

If however, the tax return indicates that tax is payable, the taxpayer should pay that tax and deliver their tax return to an authorized bank by the last day of Jawza. In such cases, the Afghanistan Revenue Department will arrange to collect the tax return from the authorized bank and will treat those tax returns as having been filed at the tax office.

- 93.2 Tax specified in an assessment notice must be paid on the date specified in the assessment notice. A tax return submitted by a taxpayer will be treated as a notice of assessment and must be paid when the return is submitted. Unless the assessment notice is a jeopardy assessment, an assessment notice issued by the Afghanistan Revenue Department will require payment on a date which will usually be 30 days from the date the notice is mailed or sent by the Afghanistan Revenue Department to the taxpayer.

Example: *Company A is an Afghan corporation. It filed its return for 1385 on the fourth day of Jawza, 1386. Two years later, during 1388, the Afghanistan Revenue Department reviews the tax return and determines that Company A understated the amount of tax that is due. The Afghanistan Revenue Department issues an assessment notice for the additional tax. The assessment notice is not a jeopardy assessment. The assessment was given to a reliable courier service on the first day of Aqrab. The assessment will specify a date that is usually 30 days later. The payment must be received by this date.*

- 93.3 Residents and non-residents who leave the country, and who will be out of the country when their tax return is due, must prepare and file their tax return two weeks before departing the country.

Example: *Jane Smith is an English citizen, but is also considered a resident of Afghanistan. Jane knows that she will be leaving Afghanistan during the month of Saur and that she will remain outside of Afghanistan for the next three months. Jane must prepare and file her tax return two weeks before departing Afghanistan.*

- 93.4 The business receipts tax form must be filed quarterly. Every person that derives income other than a salary from a trade or business must file a business receipts tax form, even though no business receipts tax may be due.

Example 1: *An individual operates an electrical supply store in Kabul. The business is not operated as a corporation, limited liability company, or partnership. The individual is not required to file a business receipts tax form, because individuals are only subject to business receipts tax if they provide certain specific types of services (ie 'taxable services' ie., hotel, telecommunications, restaurants, or airline services)*

Example 2: *An individual operates a restaurant in Mazar-e-Sharif. The restaurant is not formed as a corporation, limited liability company or partnership. The individual generates Afs. 80,000 in the first month of operation, Afs. 70,000 in the second month, and Afs. 95,000 in the third month. The individual must file a business receipts tax form every quarter, even though the individual generated less than Afs. 100,000 Afs. in each month during the quarter.*

93.5 Taxpayers subject to “fixed tax” under Articles 76 and 77 are required to pay their tax quarterly on the 15th day of the month following the end of each quarter.

93.6 To the extent that a taxpayer is subject to tax under Article 30, the tax is due on the date that the property is transferred.

Example: *Najibullah sells his truck for Afs. 50,000 on the 15th day of Hamal. The sale is subject to a fixed tax of 2% of Afs. 50,000, or Afs. 1,000. Najibullah should remit Afs. 1,000 to the government on the 15th day of Hamal.*

93.7 Income tax on the gains by brokers must be paid within five days after the end of the broker’s tax year.

93.8 The income tax (or tax in lieu of an income tax) on shows, exhibitions, theaters, cinemas, concerts and sports shall be paid no later than the fifteenth day of the next month. If the shows are not continuous, tax shall be paid after the end of each show.

Example 1: *Azziz operates a cinema in Kabul. He shows movies every night except for Friday. Azziz is subject to the tax in lieu of income tax in Article 74 of the Income Tax Law. Azziz receives Afs. 100,000 of revenue in the month of Hamal. Azziz must remit Afs. 10,000 of tax to the government by the 15th day of Saur.*

Example 2: *Wahid occasionally produces folk music shows in Herat. The music consists of classic Afghan music performed by Afghan musicians. The shows are not regular. Instead, Wahid will organize a show when he believes that there will be a significant number of tourists in the Herat area. During the month of Saur, Wahid organizes a show that attracts a number of tourists. Wahid generates Afs. 5,000,000 from the show. Wahid must remit Afs. 500,000 to the government on the day after the show ends.*

93.9 In the event that the due date for filing a tax return or making a tax payment falls on a Friday or a legal holiday, the return or payment may be filed, without late filing penalties, on the next business day following the Friday or legal holiday.

Objections and Appeals

Article 94

(1) Where a person has delivered a tax return required under this Law or has received an assessment notice and that person believes that the tax return or assessment is incorrect, the person can request an amendment of the assessment notice within five years of the date on which the tax return was due.

(2) The Ministry of Finance may amend or affirm an assessment notice and will advise the person of its decision.

If the Ministry of Finance has not amended an assessment notice as requested within 60 days after the date on which a person delivered a request for amendment, the earlier assessment notice will be treated as being affirmed.

If the person liable to pay the tax assessed in the amended assessment notice or affirmed assessment notice believes that the amended assessment notice or affirmed assessment notice is incorrect, the person may submit to the Ministry of Finance an objection within 30 days after receiving the amended assessment notice or the assessment notice being otherwise affirmed.

The objection will be considered by the Objection Review Panel which may affirm or amend the assessment notice in whole or in part.

Where a person does not accept the decision of the Objection Review Panel or the Objection Review Panel has not made a decision within 60 days after receiving the objection, the person may appeal to a court within 30 days after receiving the decision or the assessment notice being otherwise affirmed.

The decision of the court will be final.

- 94.1 A taxpayer may only request an amendment to his tax return or challenge an assessment within five years from the date on which the tax return was due. Notwithstanding the foregoing, if an assessment is not received by the taxpayer at least 30 days before the five year period expires, the taxpayer shall have 30 days from the date that he receives the assessment to respond to the assessment.

Example 1: *Company A is an Afghan corporation that filed its return for the year 1385 on the last day of Jawza, 1386. During the year 1388, Company A realizes that it failed to deduct certain interest expenses from its taxable income during its 1385 year. Company A may request an amendment to its tax return, but only if Company A does so before the last day of Jawza, 1391.*

Example 2: *Company A filed its income tax return for the year 1385 on the 15th day of Jawza, 1386. On the 2nd day of Hamal, 1391, the Afghanistan Revenue Department examines Company A's tax return and realizes that Company A understated its income. The Afghanistan Revenue Department sends an assessment notice to Company A on 20th day of Jawza, 1391. Company A does not receive the assessment until the last day of Jawza, 1391. Company A has 30 days to either accept the notice of assessment or request an amendment under Article 94(1).*

- 94.2 If a taxpayer makes a request to amend a notice of assessment, the Ministry of Finance has 60 days to determine whether or not to agree to the amendment. The 60 day period begins on the date that the taxpayer delivers the request to a tax office or to a reliable mail delivery or courier service. Taxpayers who are not making delivery to a tax office are encouraged to send their request for amendment through a courier that requires the recipient to acknowledge receipt with a signature. Taxpayers are also encouraged to clearly indicate the date on which the request for amendment was sent on their letter requesting the amendment.

Example: *Company A filed its tax return for the tax year 1385 on the last day of Jawza, 1386. During 1388, the Afghanistan Revenue Department determined that Company A understated its taxable income by Afs. 1,000,000. The Afghanistan Revenue Department issued an assessment notice on the first day of Hamal, 1389. Company filed a request that the assessment be amended on the first day of Jawza, 1389. The request clearly stated the date on which the request was made. The request for amendment was given to a reliable courier that requests confirmation of receipt via signature. The Afghanistan Revenue Department has 60 days from the first day of Jawza to respond. If the Afghanistan Revenue Department fails to respond, the Afghanistan Revenue Department will be deemed to have rejected the request for amendment.*

- 94.3 In making a decision on a taxpayer's request for amendment, the Afghanistan Revenue Department should carefully review the taxpayer's file to ensure that the assessment is proper.
- 94.4 Once the Ministry of Finance has reviewed the taxpayer's request for amendment, and advised the taxpayer of its decision, the taxpayer may file a notice of objection with the Ministry of Finance if he/she wishes to dispute that decision. If the taxpayer chooses to raise an objection, the taxpayer must do so within 30 days of receiving the Ministry of Finance's response to the taxpayer's request for amendment. In the event that the Afghanistan Revenue Department did not respond to the taxpayer's request, the Afghanistan Revenue Department will be deemed to have given a negative answer on the 60th day after the taxpayer filed its request for amendment. Taxpayers will be deemed to have provided their objection to the Ministry of Finance on the day that they submit their objection notice to a tax office or to a reliable mail delivery service or courier.

Example: *Adib filed his tax return for the tax year 1385 on the last day of Jawza, 1386. During 1389, the Afghanistan Revenue Department examined Adib's return and determined that Adib made a number of errors in his return. On the first day of Hamal, 1390, the Afghanistan Revenue Department issued a notice of assessment to Adib. Adib mailed a request that the assessment be amended on the last day of Hamal to the Ministry of Finance. Adib used a reliable courier service. The Afghanistan Revenue Department failed to respond within 60 days of the date that Adib mailed the request. Adib can consider the failure to respond a denial of his request. If Adib wants to pursue the matter, he must file a notice of objection within 30 days of the date that his request is deemed to be denied. This is the same as the date that is 90 days after the date that Adib filed his request for amendment.*

- 94.5 The taxpayer's objection will be determined by an "objection review panel." There is no permanent sitting objection review panel within the Afghanistan Revenue Department. Instead, an objection review panel must be assembled from independent Afghanistan Revenue Department employees. Each objection review panel must consist of 3 individuals. All of the foregoing individuals must be unrelated to the taxpayer at issue. None of the foregoing individuals should have participated in the taxpayer's case or file before the objection review panel was assembled.
- 94.6 Once the objection review panel receives the case, they should review all of the facts contained in the taxpayer's file. In addition, the panel should consider whether oral or written statements from the taxpayer or the responsible Afghanistan Revenue Department officials would assist in the determination of the case. If additional statements would be warranted, the panel may hold meetings with the taxpayer and/or the Afghanistan Revenue Department officer. If the panel believes additional documents would be helpful for resolving the case, it should request them, in writing, from the taxpayer or the Afghanistan Revenue Department official.
- 94.7 In reaching its decision, the objection review panel should recognize that if the taxpayer does not accept the panel's finding, the taxpayer has the right to challenge the determination in court. Thus, the panel should make its decision based on its understanding of the likelihood that the Afghanistan Revenue Department's position will be upheld or sustained if the taxpayer's case was tried before a court.
- 94.8 The objection review panel will make its decision by majority vote. The panel should communicate its decision in writing. The panel is encouraged to also inform the taxpayer by telephone.
- 94.9 If a settlement is reached, the objection review panel and the taxpayer should enter into a definitive agreement setting forth the relevant facts and the settlement that was reached for each of the years at issue.

Refunds

Article 95 If the Ministry of Finance finds, upon examination of a return, claim, or judgment of the Court, that the tax paid is in excess of the amount due, it shall first apply the overpayment against any other taxes or custom duties of the person then due and, with the person's agreement, to another person's tax liability and then refund the excess following procedures set out in the Income Tax Manual.

95.1 The Ministry of Finance cannot release funds to a taxpayer until the taxpayer's case has been finally adjudicated. A final adjudication includes:

- (a) The Afghanistan Revenue Department's acceptance of a taxpayer's refund claim or request for amended assessment.
- (b) A definitive settlement between the taxpayer and the Ministry of Finance pursuant to the Ministry of Finance's authority under Article 94 of the Income Tax Law.
- (c) A final judgment of a court. A final judgment means a decision by a court that cannot be appealed.

95.2 Once there has been a final adjudication of a taxpayer's claim, the Afghanistan Revenue Department official in charge of the taxpayer's file shall check the taxpayer's file to ensure there are no other outstanding tax liabilities against which any credit balance should be applied. If this checking shows that there are no other outstanding tax liabilities, or that there is still a credit balance remaining after offsetting other outstanding tax liabilities, the Afghanistan Revenue Department official shall then check that the taxpayer does not have any outstanding customs duty liability.

95.3 If the taxpayer has outstanding liability for customs duty, the Afghanistan Revenue Department official should contact the Treasury Department and the Customs Department to ensure that the taxpayer's customs liability is credited by the amounts owed to the taxpayer.

95.4 Any amounts that are still owed to the taxpayer after making appropriate credits for other outstanding taxes and customs duty should, in the following order, be:

- (a) offset against the tax liabilities of another taxpayer, where the taxpayer has requested this action,
- (b) refunded to the taxpayer via the Treasury Department, where the taxpayer has requested this action, or
- (c) held as a credit against future tax liabilities of the taxpayer.

Information collection

- Article 96 (1) In order to ascertain the correctness of any return or make an estimate of the income of any person, the Ministry of Finance shall have the power to –
- a. examine the books, papers, or records of the person through designated employees of the Ministry of Finance; and
 - b. require information on the income, expenses, or assets of the person from other persons.
- (2) The Ministry of Finance may specify the procedures for examination of a person's books, papers, or records in the Income Tax Manual.
- (3) All information collected by the Ministry of Finance on an income tax return and in exercise of the power provided in paragraph (1) of this Article is confidential and may not be disclosed by the Ministry of Finance to anyone outside the Ministry of Finance unless authorized by law.

- 96.1 The Afghanistan Revenue Department's procedures for auditing taxpayers are contained in the Audit Manual.
- 96.2 Any information that a Ministry of Finance employee receives with respect to a taxpayer must remain confidential.
- 96.3 If a Ministry of Finance employee knowingly discloses confidential information to a person outside of the Ministry of Finance, the employee may be subject to disciplinary action, including termination of employment. Disciplinary action will not be taken without the approval of the Deputy Minister of Revenue and Customs and the Minister of Finance. If the Deputy Minister is suspected of disclosing confidential information, disciplinary action may be taken by the Minister of Finance. If the Minister of Finance has disclosed confidential information, disciplinary action may be taken by the Council of Ministers.
- 96.4 If a Ministry of Finance employee knowingly discloses confidential information to a person outside of the Ministry of Finance in order to achieve a personal benefit, the Ministry of Finance may seek to convict the employee under Article 111(1) of the Income Tax Law.

CHAPTER XIV

ENFORCEMENT PROVISIONS

Article 97 – Article 101

Collection of unpaid tax from third parties

Article 97 (1) For the purpose of recovering any tax due by a taxpayer, the Ministry of Finance may, without the agreement of the taxpayer, by notice in writing, require payment from any person: –

1. owing money to the taxpayer;
2. holding money for the taxpayer;
3. holding money on behalf of some other person for payment to the taxpayer;
4. having authority of some other person to pay money to the taxpayer;
or
5. who is liable to make payments of salary or wages or other similar payments to a taxpayer.

97.1 Collection may be from anyone who owes money to the taxpayer. While it is impossible to comprehensively identify everyone who might owe a taxpayer money, one example is shown here and others follow in 97.2 through 97.5. Debt owing to a taxpayer may take many and varied forms but includes, beyond these examples, uncollected business accounts receivable, estate proceeds, amounts for any contracts completed, installment loans, promised advances or deposits, royalties due, commission payments, copyright payments, franchise payments, return on investments, stocks and bonds, safe deposits, rents, leases, etc.

Example: *There exists a contract showing that the taxpayer loaned money to a friend. The due date for repayment has passed. The taxpayer will not voluntarily pay the tax or can't be located.*

Loan amount	Afs. 100,000
Tax due	Afs. 50,000
<u>Amount collectable from friend</u>	<u>Afs. 50,000</u>
Remaining tax due	-0-

97.2 Collection may be from anyone who is holding money for the taxpayer.

Example: *The taxpayer has a bank account.*

Amount in bank account	Afs. 200,000
Tax due	Afs. 50,000
<u>Amount collectable from bank</u>	<u>Afs. 50,000</u>
Remaining tax due	-0-

or---

Amount in bank account	Afs. 40,000
Tax due	Afs. 50,000
<u>Amount collectable from bank</u>	<u>Afs. 40,000</u>
Remaining tax due	Afs. 10,000

- 97.3 Collection of unpaid tax may be from anyone who is holding money in an account for payment to the taxpayer.

Example: *An insurance company is holding money for the taxpayer to satisfy a lump sum policy pay-off.*

Policy pay-off to taxpayer	Afs. 533,000
Tax due	Afs. 196,000
<u>Amount collectable from insurance</u>	<u>Afs. 196,000</u>
Remaining Tax Due	Afs. -0-

- 97.4 Collection may be from anyone who has the authority and obligation to pay money to the taxpayer.

Example: *The taxpayer's occupation is painting houses. The taxpayer has not been paid for two completed houses.*

Money due from house owner #1	Afs. 10,000
Money due from house owner #2	Afs. 12,000
Tax due	Afs. 298,000
<u>Amount collectable from owners</u>	<u>Afs. 22,000</u>
Remaining tax due	Afs. 276,000

- 97.5 Collection may be from any natural or legal person who is liable for paying salary, wages or similar payments to the taxpayer.

Example: *Weekly salary from company to taxpayer (after deducting wage withholding tax)*

Tax due	Afs. 21,000
<u>Amount collectable from company</u>	<u>Afs. 5,000</u>
Remaining tax due	Afs. 16,000

Remark: *Normal practice would be to leave the taxpayer minimum living expense. The documented decision, therefore, might be to only take 3,000 Afs. each week until the tax liability is fully paid (3,000 x 7 weeks for 21,000 in tax).*

Liability of directors, shareholders and other persons

Article 98 Where a company has failed to pay income tax as required under this Law, the Ministry of Finance may collect the tax due from the following persons:

- (1) any or all of the directors of the company who has failed to exercise care in ensuring the company met its tax liability;
- (2) a shareholder of the company with a 10 percent or greater ownership interest in the company, but only to the extent that the shareholder received dividends from the company;
- (3) a person who has obtained one or more assets from the company for less than its market value in the course of a transaction that took place within the three years preceding the date on which the unpaid tax was due.

98.1 Income tax liability can be collected from any or all of the directors of the company who have failed to exercise care in assuring that the company met its tax liability.

Example: *Nine directors of Company X agreed to delay payment of taxes in order to purchase earth moving equipment. Board of director meeting minutes documented this decision. The tax liability may be collected from the personal assets of any single director or divided among them in any way. Judgments about collection efficiency and fairness will be made by the Afghanistan Revenue Department.*

98.2 Income tax liability can be collected from any shareholder who owns ten percent or more of the company, but only to the extent that the shareholder receives company dividends.

Example: *Afco has income tax owing of Afs. 1,000,000. Afco's shareholding and dividend payments are as follows.*

<i>Name of Shareholder</i>	<i>Shares Owned</i>	<i>Dividends Received</i>	<i>Percentage Ownership</i>	<i>Tax Collected</i>
<i>W</i>	<i>20,000</i>	<i>200,000</i>	<i>20%</i>	<i>200,000</i>
<i>X</i>	<i>20,000</i>	<i>200,000</i>	<i>20%</i>	<i>200,000</i>
<i>Y</i>	<i>30,000</i>	<i>300,000</i>	<i>30%</i>	<i>300,000</i>
<i>Z</i>	<i>30,000</i>	<i>300,000</i>	<i>30%</i>	<i>300,000</i>

Total collected = Afs. 1,000,000.

Balance due -0-

In this example the shareholders owned at least 20%, however collection can be sought from any shareholders who own 10% or more. Shareholders who own less than 10% are not liable under this provision. Also, it is important to remember that collection

liability depends on dividends received. If there has been no payment of dividends, there can be no collection of the company's income tax from shareholders. If a shareholder owns 40% of the company shares but only receives 10% of the dividends then collection from that person may not exceed the amount of dividends received.

- 98.3 Income tax liability can be collected from any person who has obtained assets of the company for less than fair market value in a transaction within three years before the due date of the tax liability.

Example 1: *A company owns thirty buildings. Three of these buildings were sold within one year before the date the company was due to pay its income tax liability. The three buildings were sold to the brothers of the company president for less than their market value. The company's income tax may be collected from the purchasers of the buildings on the following basis.*

Building	Market Value	Sale Price	Tax Collectable New Owner
A	20,000,000	5,000,000	15,000,000
B	38,000,000	5,000,000	33,000,000
C	39,000,000	5,000,000	34,000,000

Example 2: *A company owned Mercedes car has a market value of Afs. 1,000,000. It was sold two days before an unpaid tax debt was due. The debt was for Afs. 3,332,000. The sale price of the car was Afs. 100,000. The new owner of the car is liable for Afs. 900,000.*

Persons not allowed to leave Afghanistan

Article 99 (1) A person who has tax due of more than 20,000 afghanis may be prevented from departing Afghanistan if the tax due has not been paid to the relevant tax office. An authorized person of the Ministry of Finance may issue a notice to the relevant authorities requesting that those authorities prevent the person from departing Afghanistan.

- 99.1 Taxpayers who owe more than 20,000 Afs. in tax liability can be prevented from leaving the country unless they:
- a. Pay the overdue tax to the bank and present a receipt for proof of payment to the Afghanistan Revenue Department; or
 - b. Make satisfactory arrangements with the Afghanistan Revenue Department before leaving (for example, collateral or a binding agreement, and proof of return)
- 99.2 Authorized staff of the Afghanistan Revenue Department, on learning that a taxpayer is seeking to leave Afghanistan before paying or making arrangements (where more than 20,000 Afs. is owed), may issue a Departure Prohibition Order. The Order will reference this Article of the Law (requirement to stop taxpayers from leaving Afghanistan) and include details of the tax due. The Departure Prohibition Order should be personally delivered by the Afghanistan Revenue Department to:
- a. The Ministry of Interior,
 - b. The Ministry of Transport, and to
 - c. Any other government authority obligated to assist.
- 99.3 A Departure Prohibition Order can be issued to a person who has tax due. A person in this case can only be a natural person. A Departure Prohibition Order cannot be issued to a legal person ie a company or any other organisation.
- 99.4 The requirement that a person has 'tax due' means that the person must have been assessed tax and has not paid the tax due. An assessment to tax can arise either on the person submitting a tax form or the issue of a 'default assessment' by the Ministry of Finance. An amended assessment issued by the Ministry of Finance may also result in tax being due and payable. A person will not be considered to have 'tax due' where they have not submitted a tax form to the Ministry of Finance or the Ministry of Finance has not issued a default assessment.
- 99.5 A person will be considered to have 'tax due' where that person has been assessed to tax but has not paid it. A person will also be considered to have 'tax due' where that person is required to pay the tax of a company according to Article 98. Where Article 98 applies, a person who is a

director, shareholder, or the purchaser of company assets below market value will be considered to have 'tax due' when the Ministry of Finance issues a notice to the person to that effect.

Example: *Company A has tax due of Afs 200,000s. Company A has not paid its tax because it has expended all its cash reserves and credit facilities on purchasing a new building for the business. A director of Company A made the decision to buy the building even though the director was aware that Company A was required to submit an income tax form and pay income tax. The director has failed to exercise reasonable care in ensuring the company met its income tax liability. The Ministry of Finance issued a notice to the director in accordance with Article 98 requiring the director to pay tax of Afs 200,000. As the director is considered to have 'tax due', the Ministry of Finance may issue a Departure Prohibition Order to the director.*

- 99.6 A person will not be considered to have tax due where that person holds or owes money to the person who has tax due.

Example: *Adib has been issued a tax assessment and has tax due of Afs 30,000. Haroon owes Adib Afs 25,000. While a Departure Prohibition Order may be issued to Adib, it cannot be issued to Haroon. Haroon is not a person who has 'tax due' in this example.*

Remark: *The Ministry of Finance may, however, issue a notice to Haroon requiring him to pay the money owed to Adib to the Ministry of Finance according to Article 97.*

Business closure

Article 100 (1) Where a person has failed to deliver a tax return, failed to pay tax on the due date or failed to withhold and pay tax as set out in the provisions of this Law, the Ministry of Finance may notify the person in writing of the intention of the Ministry of Finance to close down part or the whole of the person's business. The Ministry of Finance may issue an order to close down part or the whole of the person's business seven days after the person receives the notice. The order must be signed by an authorized person of the Ministry of Finance and will continue in effect until the person pays the tax due. The Ministry of Interior shall assist with the implementation of this order.

100.1 Where a taxpayer does not submit a tax return within the legal timeframe and does not cooperate, the Afghanistan Revenue Department may decide to issue a final demand letter.

- a. This demands that the late return(s) be submitted no later than the time specified after the taxpayer receives the final demand letter.
- b. It also advises the taxpayer that if the return(s) are not submitted within the demand period the business may be seized, either entirely or in part. If a seizure is required security assistance will be used to assure safety and full compliance.
- c. The Afghanistan Revenue Department will assure close coordination of all necessary (but not excessive, or more than needed) security assistance. The Ministry of Interior is required by this Law to provide assistance.

Example: *The case file documents that the taxpayer has been contacted three times and asked to submit a Business Receipts Tax form that is now sixty days late. The taxpayer said that the large grocery business has problems and more time is needed. Finally, the taxpayer is not willing to say when it will be possible to submit a balance sheet. The final demand letter and potential business closure should be considered.*

100.2 Where a taxpayer does not make payment, or withhold and pay, as required by the Income Tax Law and does not cooperate, the Afghanistan Revenue Department may decide to issue a final demand letter.

- a. This demands that the late payment and/or withholding failure be brought into compliance no later than the time specified after the taxpayer receives the final demand letter.
- b. It also advises the taxpayer that if all tax liability due and/or the failure to withhold are not brought into full compliance within the demand period, the business may be seized, either entirely or in

part. If a seizure is required security assistance will be used to assure safety and full compliance.

- c. The Afghanistan Revenue Department will assure close coordination for all necessary (but not excessive, or more than needed) security assistance. The Ministry of Interior is required by this Law to provide assistance.

Example 1: *The case file documents that this taxpayer is a large construction company. A return has been submitted but without any payment. The tax, penalty and interest due total Afs. 25,000,954. At two previous meetings the taxpayer said the money is coming soon from outside of Afghanistan. Thirty days after the due date no money has been submitted to the bank. The final demand letter and potential business closure should be considered.*

Example 2: *This business has been selling electric generators for six months. They have twenty-six employees and have withheld tax from them, but have neglected to pay any tax to the Ministry of Finance. The company president said that the money is needed for business expenses. "We just can't afford to pay this large withholding amount and stay in business." There is no cooperation to submit any of the money withheld. The final demand letter and potential business closure should be considered.*

Restriction on disposal of property by a taxpayer

- Article 101
- (1) Where a person has failed to deliver a tax return, failed to pay tax on the due date or failed to withhold and pay tax as required by the provisions of this Law, the Ministry of Finance may request an order of an appropriate court placing restrictions on a person's movable and immovable property until the person pays the tax due.
 - (2) Where a person does not pay the tax due within 30 days of an order of the court, the Ministry of Finance may request the appropriate court to order the sale of the person's property. Where a person pays tax due under paragraph (1) of this Article before an order of the court for sale of property is issued, the order placing restrictions on the person's property will be withdrawn.
 - (3) Where paragraph (1) of this Article applies, a court may issue an order to sell a person's property through a public auction.
 - (4) The Ministry of Finance shall apply the proceeds of the sale of property to the payment of the tax due and any excess of the proceeds shall be paid to the person.

101.1 The Afghanistan Revenue Department may request a court order to restrict taxpayers who have failed to file tax returns, make tax payments, or to withhold tax, from making property transactions. This includes a prohibition on disposing of any property. If the taxpayer satisfies his obligations before the court issues the order, it will not be implemented.

101.2 Where a tax liability is not paid within thirty days from such a court order, the Afghanistan Revenue Department may make a referral to the court for a further authorization to sell the taxpayer's property.

The court may issue an order to the Afghanistan Revenue Department to sell the taxpayer's property through auction where all tax obligations of Article 101 are not met.

After sale of the taxpayer's property all outstanding tax liability will be paid with any excess proceeds refunded to the taxpayer by the Ministry of Finance.

CHAPTER XV

ANTI-AVOIDANCE

Article 102 - Article103

Transactions between connected persons

Article 102 If any amount paid or payable in a transaction between connected persons is different than the amount that would be paid or payable had the transaction taken place between unconnected persons, when determining the tax liabilities of the connected persons, the Ministry of Finance may substitute the amount that would be paid or payable had the transaction taken place between unconnected persons.

102.1 The purpose of Article 102 of the Income Tax Law is to ensure that taxpayers do not engage in transactions with related persons in order to achieve a tax benefit that could not have been obtained had the transactions taken place between unrelated parties. The Ministry of Finance believes that Article 102 and these regulations are consistent with the Organization for Economic Cooperation and Development's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (1995).

Example 1: Asahi owns all of the issued stock of Company A and Company B. Company A and Company B are Afghan corporations. Asahi causes Company A to sell products to Company B at a price of Afs. 1,000 per unit. Identical products are being sold in the market under the same terms at Afs. 800 per unit. Asahi wanted Company A to sell the products at a higher price in order to reduce the profit of Company B and increase the profit of Company A. Company A has a net operating loss that it can use to offset the profit from selling units to Company B. Under Article 102, the Ministry of Finance can restate the profits of Company A and Company B as if Company A sold products to Company B for Afs. 800 per unit.

Example 2: Asahi owns all of the issued stock of Company A and Company B. Company A is an Afghan corporation. Company B is an Uzbek corporation. Asahi causes Company A to sell products to Company B at a price of Afs. 800 per unit. Identical products are being sold in the market under the same terms at Afs. 1,000 per unit. Asahi wanted Company A to sell the products at a lower price in order to reduce the profit of Company A and increase the profit of Company B. The result will be that Company A pays less tax in Afghanistan. Under Article 102, the Ministry of Finance can restate the profits of Company A as if Company A sold products to Company B for Afs. 1,000 per unit.

102.2 Taxpayers are "connected" with each other if their actions are controlled by the same person or entity. For this purpose, a taxpayer's spouse, brothers, sisters, children and parents will all be considered connected to each other. Whether or not other taxpayers are under the control of the same person will be determined based on the facts and circumstances. Nevertheless, the Afghanistan Revenue Department will apply the following rules in determining whether two taxpayers are controlled by the same person.

- a) A taxpayer is connected with a legal person (e.g., partnership, limited liability company or corporation) if the taxpayer owns more than fifty percent of the voting rights in the entity.

Example 1: Wahid owns 51% of the issued stock of an Afghan corporation. Unrelated parties own the remaining 49% of the stock of the corporation. The corporation has a single class of stock issued. Wahid's stock gives Wahid the right to elect the majority of the corporation's board of directors. Wahid is therefore connected with the Afghan corporation.

Example 2: Company A is an Afghan corporation that has a single class of stock issued. Wahid owns 20% of the issued stock of Company A. Wahid's wife, Asieh, owns 20% of the issued stock of Company A. Wahid's son, Najib, owns 12% of the issued stock of Company A. Wahid, Asieh and Najib are all considered connected persons. They are all considered connected with Company A.

- b) A taxpayer is connected with a legal person if the taxpayer owns more than fifty percent of the voting rights of the entity indirectly.

Example 1: Wahid owns 80% of the issued stock of Company A, an Afghan corporation. Company A owns 80% of the issued voting interests in Partnership B, an Afghan limited partnership. Wahid will be considered connected with Company A because he owns more than 50% of the voting rights in Company A directly. He will also be considered connected with Partnership B, because he owns 64% of the voting rights in Partnership B indirectly ($80\% \times 80\% = 64\%$).

- c) If two legal persons are considered to be connected to the same taxpayer, the two legal persons will be considered to be connected with each other.

Example 1: Wahid owns 80% of the issued stock of Company A. Company A is an Afghan corporation. Wahid also owns 51% of the voting rights in Partnership B. Partnership B is an Afghan limited partnership. Wahid is considered to be connected with Company A and Partnership B. Moreover, Company A and Partnership B are considered to be connected to each other.

Example 2: Company A is an Afghan corporation. Company A owns 80% of the issued stock of Company B. Company B is an Afghan corporation. Company A also owns 51% of the voting rights in Partnership B. Partnership B is an Afghan limited partnership. Company A is considered to be connected with Company B and Partnership B. Moreover, Company A and Partnership B are considered to be connected to each other.

- d) A taxpayer will be considered "connected" with a legal person if the taxpayer owns less than a majority of the voting rights in that legal

person, if the facts and circumstances indicate that the taxpayer has the power to control the decisions of the company.

Example 1: *Zaid owns 50% of the issued stock of Company A, an Afghan corporation. Zaid's two cousins, Saad and Najib, each own 25% of the Afghan corporation. Zaid, Saad and Najib are not connected with each other, because they are cousins. Nevertheless, a review of the minutes of the board of directors meetings and shareholders meetings for Company A indicates that Saad and Najib take direction from Zaid and typically vote the way that Zaid wants them to vote. Thus, Zaid should be considered to control Company A and be connected to Company A.*

Example 2: *Zaid owns 50% of the issued stock of Company A, an Afghan corporation. Zaid's two cousins, Saad and Feroz, each own 25% of the Afghan corporation. Zaid, Saad and Feroz are not connected with each other, because they are cousins. Moreover, after investigation, the Afghanistan Revenue Department learns that Zaid disagrees with Saad and Feroz about many issues. All three individuals have very different ideas about how to operate Company A. Moreover, no single individual controls the operation of Company A. In this case, Zaid should not be considered connected to Company A.*

- 102.3 A “connected transaction” is any transaction between connected taxpayers. An “unconnected transaction” is any transaction between taxpayers that are not connected. The price at which a connected transaction takes place is called a “transfer price”.

Example: *Wahid owns all of the issued stock of Company A, an Afghan corporation. Wahid also owns all of the issued stock of Company B, an Afghan corporation. Wahid, Company A and Company B are all considered “connected” taxpayers. If Company A sells a product to Company B, the sale is considered a connected transaction. The price that Company B pays for the good is considered the transfer price.*

- 102.4 In determining the true taxable income of taxpayers under Article 102, the Afghanistan Revenue Department should look to unconnected transactions.

Example: *Wahid owns all of the issued stock of Company A, an Afghan corporation. Wahid provides services to Company A every year as the president of Company A. Company A pays Wahid for his services as president. Wahid knows that Company A will be entitled to a deduction for every Afghani that Company A pays Wahid. Wahid also knows that Company A is taxed at a 20% rate, but that Wahid is taxed on some of his income at a 0% rate and a 10% rate. To determine whether or not the payments made by Company A to Wahid comply with Article 102, the Afghanistan Revenue Department must look to the salaries that other companies pay presidents in unconnected transactions. For example, assume that Company B, an Afghan corporation, is similar to Company A. It is approximately the same*

size as Company A. It is in the same business as Company A. Company B is not controlled by any single individual. Company B is not owned by the government or any branch of the government. Company B pays its president Afs. 10,000,000 per year. The salary that Company B pays its president is an unconnected transaction. The Afghanistan Revenue Department can use that transaction to determine whether or not the salary paid to Wahid is reasonable.

102.5 The Afghanistan Revenue Department may use a number of different methods, described below, to determine what the correct price would be between unconnected persons. Each method relies on different types of unconnected transactions to determine the appropriate taxable income. Thus, to determine the best method, the Afghanistan Revenue Department should consider the similarity between the connected transactions and unconnected transactions used with respect to each method. In particular, the Afghanistan Revenue Department should consider the following facts and circumstances:

- a) Functions. The functions performed in the connected transaction and unconnected transaction should be similar. If the functions performed in the connected transaction and the unconnected transaction are similar, the unconnected transaction will be more helpful in determining the accurate transfer price. If the functions performed in the connected transaction and the unconnected transaction are not similar, the unconnected transaction will be less helpful in determining the accurate transfer price.

Example: *Adib owns all of the issued stock of Company A, an Afghan corporation. Company A operates a business in the Wazir Akbar Khan area of Kabul. The store sells used automobiles. Adib also owns 60% of the voting rights in Partnership B, an Afghan limited partnership. Partnership B operates a business near Kabul that sells spare auto parts. Partnership B does not offer any assistance with the repair of the automobile itself. Partnership B only sells the parts. When Company A purchases an automobile for the automobile shop, Company A will usually need to repair the vehicle. Company A will always purchase the spare parts from Partnership B. Adib is connected with Company A. Adib is connected with Partnership B. Thus, Company A and Partnership B are connected with each other. The price that Partnership B charges Company A for spare parts is a "transfer price." To determine whether the transfer price complies with Article 102, the Afghanistan Revenue Department will review unconnected transactions. There are two unconnected transactions that the Afghanistan Revenue Department identifies. The first unconnected transaction involves Company C. Company C is an Afghan corporation that is located near Kabul. Company C sells auto parts to various customers in the Kabul area. Company C does not assist in the repair of the automobile. It only sells auto parts. The second unconnected transaction involves Company D. Company D is an Afghan corporation. Company D is also located near Kabul.*

Company D sells auto parts in the Kabul area. Company D employs a number of mechanics. Company D provides significant assistance to anyone who purchases auto parts. Company D helps the purchaser of the parts to determine how the repair work should be done. Company C transactions are similar to Partnership B's transactions, because the functions of the first company and Partnership B are similar. Hence, Company C's transactions may provide better evidence of the correct transfer price.

- b) Contractual Terms. The contract terms used in the connected and unconnected transactions should be similar. In this respect, the Afghanistan Revenue Department should focus on terms that relate to the economic arrangement between the parties (*i.e.*, payment terms, time for performance, etc.).

Example: *Daood owns all of the issued stock of Company A. Company A is an Afghan corporation. Company A publishes a magazine. Company A sells the magazines for money. Company A also charges people money for printing advertisements in the magazine. Daood also owns Company B. Company B is an Afghan corporation that operates a courier service. If someone wants to send a document from one location to another within a particular Afghan city, they can contact the courier service and pay the courier to deliver the document. Company B usually guarantees that the document will arrive at its destination within one day. Company B charges Afs. 100 for the delivery. Company A always uses Company B's courier service when it wants to deliver a document to someone. But when Company B provides services to Company A it does not guarantee that the document will be delivered in one day. It only charges Company A Afs. 80 for the delivery. The price charged by Company B to Company A is not necessarily unacceptable. This is because Company B provides delivery services to most of its customers on the same day that Company B receives the document. Company B does not provide the same timely service to Company A. Thus, it may be appropriate under these facts that Company B charges Company A less money. Thus, if possible, the Afghanistan Revenue Department should try to find an unconnected transaction that more closely matches the connected transaction.*

- c) Risks. The risks borne by the parties in the connected and unconnected transactions should be similar.

Example: *Adib owns all of the stock of Company A, an Afghan corporation, that imports motorcycles. Adib also owns all of the issued stock of Company B, an Afghan corporation that purchases motorcycles from Company A and sells them to customers throughout Afghanistan. When Company A sells the motorcycles to Company B, Company A bears the risk that there will be a loss during shipment. Thus, if a motorcycle is lost or damaged during transit, Company A bears the loss, not Company B. When the Afghanistan Revenue Department is*

analyzing unconnected transactions, it should try to find unconnected transactions where the seller bears the risk that a loss will occur during the transportation of the products.

- d) Economic Conditions. Afghanistan is emerging from a conflict environment. Thus, in analyzing connected and unconnected transactions, the Afghanistan Revenue Department must be careful to take into account the relevant economic conditions. In particular, the level of profit that one might expect from a business in Afghanistan may be dramatically different from the level of profit that one may expect from a business located in a more developed country, given the risks of investing in a post-conflict environment. Thus, in determining the correct transfer price, the Afghanistan Revenue Department is encouraged to look to the profit levels that are generated with respect to similar investments under similar economic conditions.

Example: *The Afghanistan Revenue Department is investigating Company A. Company A is an Afghan corporation that purchases radios from a connected person in China. Company A then sells the radios to various stores in Afghanistan. In determining whether the price paid by Company A for the radios is reasonable, the Afghanistan Revenue Department could look to transactions between unconnected parties in more developed countries. In reviewing these transactions, the Afghanistan Revenue Department should carefully consider whether the special economic and other conditions in Afghanistan make those other transactions less helpful in providing guidance.*

- e) Similarity of Property or Services. In ascertaining the correct transfer price, the connected and unconnected transactions should involve similar property or services. If the connected transaction involves the sale of a car, the Afghanistan Revenue Department should attempt to find comparable unconnected transactions involving the sale of a car. The Afghanistan Revenue Department should not attempt to rely on an unconnected transaction involving the sale of a motorcycle, because the sale of a motorcycle is very different than a sale of a car.

102.6 It may be necessary in certain cases to make adjustments to ensure that the unconnected transaction is comparable to the connected transaction.

Example: *The connected transaction involves a sale of auto parts from Company A to Company B for Afs. 300,000. The terms of sale require that Company A bear the risk that the auto parts may be lost or damaged as they are transferred to Company B. The Afghanistan Revenue Department has identified one unconnected transaction that is comparable to the foregoing transaction. In the unconnected transaction, however, the purchaser bears the risk of loss for the parts during the time that the goods are transported. The Afghanistan Revenue Department may, in this case, adjust the price used in the unconnected transaction upward to approximate the sales price that*

would have been used in the unconnected transaction had it been structured in the same way as the connected transaction.

- 102.7 In some cases, the application of a pricing method (described below) may generate a single result that represents the best indication of what the appropriate transfer price should be. Alternatively, application of a pricing method may generate a range of results.

If each of the unconnected transactions is similar in all material respects to the connected transactions, or can be adjusted so that it is similar in all material respects, then all of the results create a range of reasonable transfer prices. If the taxpayer's transfer price falls within that range of results, then the taxpayer's transfer price should not be adjusted.

If, however, all material differences cannot be eliminated, then the results should be divided into three distinct categories. The first category should include the lowest 25% of the results. The second category should include the next 50% of results. The third category should include the last 25% of results. If the taxpayer's transfer price is within the second category, the taxpayer's transfer price should not be adjusted. If the transfer price is in the first or third category, the Afghanistan Revenue Department has the authority to restate the transfer price so that it is within the second category.

Example 1: *Adib is an Afghan citizen. Adib owns all of the issued stock of a Canadian corporation. Adib also owns all of the issued stock of an Afghan corporation. The Canadian corporation sells raw materials including color dyes and ink to the Afghan corporation. The Afghan corporation uses those dyes and ink to produce carpets. The Afghan corporation then sells those carpets to customers throughout the world. The Afghanistan Revenue Department locates 4 comparable transactions involving the sale of color dyes. The results are listed below:*

<i>1st Comparable Transaction</i>	<i>100 Afs. per Liter</i>
<i>2nd Comparable Transaction</i>	<i>300 Afs. per Liter</i>
<i>3rd Comparable Transaction</i>	<i>380 Afs. per Liter</i>
<i>4th Comparable Transaction</i>	<i>500 Afs. per Liter</i>

If all of these unconnected transactions are similar in all material respects to the connected transaction, then the range of reasonable transfer prices is Afs. 100 to 500 per liter. If the connected transaction falls within that range, it should not be adjusted.

Example 2: *The facts are the same as in Example 1, except that the comparable transactions are not similar in all material respects with the connected transaction. Moreover, adjustments cannot be made to ensure that the comparable unconnected transactions will be similar in all material respects to the connected transaction. Thus, the foregoing comparables should be separated into categories. The 1st Comparable*

Transaction represents the bottom 25% of the results. The 2nd and 3rd comparables fall into the middle 50% of results. The 4th comparable is in the top 25% of results. Hence, if the Canadian corporation sells colored dyes to the Afghan corporation at a price that is more than Afs. 100 per liter, but less than Afs. 500 per liter, then the transfer price should not be adjusted.

In certain situations, the number of results will not be a multiple of the number four (4). In these cases, all of the results should be added and then divided by the number of results to create an average. This average should be added to the lowest result and divided by two. This figure will establish the highest result in category one. The average should be added to the highest result and divided by two. This figure will establish the lowest result in category three.

Example 3: *Adib is an Afghan citizen. Adib owns all of the issued stock of a Canadian corporation. Adib also owns all of the issued stock of an Afghan corporation. The Canadian corporation sells raw materials including color dyes and ink to the Afghan corporation. The Afghan corporation uses those dyes and ink to produce carpets. The Afghan corporation then sells those carpets to customers throughout the world. The Afghanistan Revenue Department locates 7 comparable transactions involving the sale of color dyes. The results are listed below:*

<i>1st Comparable Transaction</i>	<i>100 Afs. per Liter</i>
<i>2nd Comparable Transaction</i>	<i>300 Afs. per Liter</i>
<i>3rd Comparable Transaction</i>	<i>380 Afs. per Liter</i>
<i>4th Comparable Transaction</i>	<i>500 Afs. per Liter</i>
<i>5th Comparable Transaction</i>	<i>520 Afs. per Liter</i>
<i>6th Comparable Transaction</i>	<i>540 Afs. per Liter</i>
<i>7th Comparable Transaction</i>	<i>600 Afs. per Liter</i>

There are differences between these transactions and the controlled transaction. Adjustments cannot be made to eliminate these differences. Thus, a range of reasonable results must be created. There are seven results. If the number of comparable transactions (7) is divided by the number four (4), the result will be a fraction ($1\frac{3}{4}$). Thus, the results should be added together and divided by seven (7). This average figure is 420. The lowest result is 100. Thus, the highest edge of the first category is 260 $(100 + 420)/2$. The highest result is 600. Thus, the lowest edge of the third category is 510. Thus, if the price charged by the Canadian company is higher than 260 and lower than 510 then it should not be adjusted.

- 102.8 If an adjustment is made to the taxpayer's transfer price, the Afghanistan Revenue Department should also be prepared to make or accept a corresponding adjustment to the income earned by the other taxpayers that

were involved in the connected transaction. Thus, if a transfer pricing adjustment has the effect of increasing the income of one connected taxpayer, a corresponding adjustment should typically be made to reduce the income of the other connected taxpayer that participated in the connected transaction. A corresponding adjustment should only be made pursuant to the following rules:

- (a) A corresponding adjustment should not be made until there has been a “final determination” of the primary adjustment.

Example 1: Corporation A is an Uzbek corporation. Corporation B is an Afghan corporation. Adib is an Uzbek resident that owns all of the issued stock of Corporation A and Corporation B. Corporation A leases equipment to Corporation B. The Afghanistan Revenue Department determines that the rent charged by Corporation A to Corporation B is Afs. 100,000 higher than the rent that would be charged between unconnected taxpayers. The Afghanistan Revenue Department increases Corporation B’s income by Afs. 100,000. If Corporation B accepts the increase and pays any resulting income tax due, then the Afghanistan Revenue Department should also make a corresponding downward adjustment in the amount of tax due with respect to the rental payment.

Example 2: The facts are the same as Example 1, but Corporation B disputes the Afghanistan Revenue Department’s position. The Afghanistan Revenue Department should not reduce the amount of tax due with respect to the rental payment unless or until there has been a final determination as to what the rental charge should be.

- (b) If a corresponding adjustment is made, the connected taxpayers may want to make a cash transfer in order to conform their books and records to the new transfer price. Thus, if a corresponding adjustment is made, the connected taxpayers should be permitted, at their option, to create a receivable and payable in their books and records with the following characteristics:
 - 1) The receivable or payable should be created as of the last day of the year in which the connected transaction took place.
 - 2) The receivable or payable should accrue a reasonable rate of interest from that date.
 - 3) The receivable or payable should be denominated in the currency of the underlying transaction.
 - 4) The receivable or payable should be large enough to cover the entire transfer pricing adjustment. The amount should not be larger than the transfer pricing adjustment. As such, the creation of the receivable/payable should not cause either party to be subject to additional tax.

Example: Corporation A is an Uzbek corporation. Corporation B is an Afghan corporation. Corporation A and Corporation B are owned by Adib, an Afghan resident. Corporation A sells goods to Corporation B during 1386. The sales are all paid for in Afghanis. The Afghanistan Revenue Department audits Corporation B's 1386 tax return during 1388. After its investigation, the Afghanistan Revenue Department determines that the transfer price charged by Corporation A to Corporation B is too high. The Afghanistan Revenue Department therefore increases Corporation B's taxable income by Afs. 1,000,000. Corporation B agrees with the revision and pays additional Afghan income tax. Corporation A and Corporation B may elect to set up a payable and a receivable equal to Afs. 1,000,000 on the last day of 1386. Corporation A will have a payable of Afs. 1,000,000 to Corporation B and Corporation B will have a receivable from Corporation A of Afs. 1,000,000. This intercompany receivable/payable must bear a reasonable rate of interest from the last day of 1386 until the amount is ultimately paid. Because the amount is the same size as the transfer pricing adjustment, the creation of the receivable/payable will not cause Corporation A or Corporation B to be subject to additional tax.

102.9 The method for determining an appropriate interest rate with respect to a loan advanced between connected parties is set forth in this regulation.

- (a) The appropriate interest rate is the rate that would be charged between two persons who are not connected pursuant to a loan with similar conditions. In determining the appropriate rate, the Afghanistan Revenue Department should look to all of the loan terms including the term of the loan, the repayment provisions, and the security provided for the repayment.

Example 1: Adib is an Afghan citizen, but he is resident in the United States of America during the year 1386. Adib lends his wholly owned Afghan corporation Afs 1,000,000. The loan bears interest at a 13% rate. The loan must be repaid in 10 years. The loan is unsecured, which means that Adib does not have a security interest in any of the corporation's assets. The Afghan corporation can demonstrate that it recently obtained a loan that has to be repaid in 8 years from a bank. The bank loan bears interest at a 12% rate. The 13% rate charged by Adib should be considered appropriate.

Example 2: The facts are the same as Example 1, but the bank loan had to be repaid in 3 years and not 8 years. In this case, the bank loan does not represent a valid comparison. Adib and his Afghan corporation will have to rely on different evidence to prove that the 13% rate is appropriate. For example, they may refer to the interest rates that banks are charging on loans with longer terms.

- (b) The Afghanistan Revenue Department shall issue procedures from time to time with respect to appropriate interest rates. In the meantime the benchmark interest rate should be based on rates charged by Da Afghanistan Bank for the use of funds. For example, Da Afghanistan Bank issues 30-day capital notes bearing a rate of interest that changes from time to time. A loan with a term of less than 1 year will be presumed to have an appropriate interest rate if the rate charged is within 3 percentage points of the rate charged on 30-day capital notes. Connected persons will always be permitted to use a rate other than the benchmark rate listed in procedures. If a different rate is used, however, the taxpayer must be prepared to show that the rate is appropriate under the preceding paragraph.

102.10 The method for determining an appropriate charge for services in a connected transaction is set forth in this regulation.

- (a) A person will usually charge a connected person a fee for services if the services provide a definite benefit for the person receiving the services and the service is one that unconnected persons would be willing to pay for. If the service does not provide a definite benefit or the service is one that unconnected persons normally do not pay for, then no charge is required.

Example: *Company A is a Pakistani corporation that owns all of the issued stock of Company B, an Afghan corporation. Company A periodically sends its representatives to Afghanistan to monitor Company B's performance and review its financial information. The services provided by Company A do not provide a definite benefit for Company B and they are not the type of services that an unconnected company would pay Company A to provide. Company A should not charge Company B for these services but if it does, Company B will not be entitled to an income tax deduction for the payment.*

- (b) If a person decides to charge a connected person for services provided, the charge should be similar to the amount that one person would charge an unconnected person for the same or similar services.

Example: *Azziz owns all of the stock of Company A. Company A is an American corporation. Azziz owns all of the stock of Company B. Company B is an Afghan corporation. Company B provides telecommunications services to customers in Afghanistan. Company A provides consulting services to Company B. The services that Company A provides include repair services and computer support services. The services that Company A provides to Company B provide a direct benefit to Company B and the services are the type of services that one person would pay an unconnected person for. Company A is entitled to charge Company B for the services that Company B receives. The amount charged should be similar to the amount that one person would charge an unconnected person for the same or similar services.*

- 102.11 The method for determining an appropriate charge for the lease or rent of tangible property between connected persons is set forth in this regulation. In summary, the appropriate charge is the amount that would have been charged for the lease or rent of the same or similar property between unconnected persons under similar circumstances.
- 102.12 The method for determining an appropriate charge for the sale or transfer of tangible property between connected persons is set forth in this regulation. In summary, there are five possible methods for determining the appropriate charge for the transfer of tangible property between connected persons.
1. Comparable Unconnected Price Method
 2. Resale Price Method
 3. Cost Plus Method
 4. Transactional Net Margin Method
 5. Unspecified Method

The best method to use is the method determined under the rules described above in Regulation 102.5.

(a) Comparable Unconnected Price Method. The purpose of the Comparable Unconnected Price method is to compare the price that is charged for the tangible property in the connected transaction to the price that is charged in unconnected transactions involving the same property.

Example 1: Azziz owns all of the issued stock of Company A and Company B. Company A is a French corporation. Company B is an Afghan corporation. Company A sells steel pipes to Company B. Company B purchases the pipes from Company A and uses them in its construction business in Afghanistan. Company A sells a one-meter pipe for Afs. 50. The sales contract provides that Company A bears all risks related to the transportation of the pipe from France to Afghanistan. Company B can demonstrate that it can buy the exact same one meter pipe from unconnected Chinese companies for Afs. 40 or Afs. 42. The Chinese suppliers will also bear all risk related to the transportation of the pipe from China to Afghanistan. The transfer price from Company A to Company B should be adjusted to reflect the fact that Company A should only be charging Company B Afs. 42 for the pipe.

Example 2: The facts are the same as in Example 1, except that the Chinese suppliers do not bear all of the risks related to the transportation of the pipe from China to Afghanistan. The Afghanistan Revenue Department estimates that the cost of insuring the risks associated with the transportation of pipe would be approximately Afs. 5 to Afs. 10 per pipe. Thus, no adjustment to the transfer price is necessary in this case.

(b) Resale Price Method. The Resale Price Method is used to determine whether the amount charged in a controlled transaction is appropriate by reference to the gross profit margin earned in similar unconnected

transactions. Gross profit equals the revenues from the sale of a product minus the cost of the product for the seller. Gross profit is not reduced by operating expenses, like advertising expense or interest expense. To determine the appropriate transfer price, the appropriate gross margin percentage is multiplied by the applicable resale price. The appropriate gross margin percentage is the ratio of the gross profit earned on sales of similar property to the sales price of the property. The applicable sales price is the price at which the connected party sells the property to unconnected persons. This method is typically used when one of the connected parties purchases and sells tangible personal property without adding substantial value to the property. For this purpose, packaging, labeling and minor assembly do not constitute the addition of substantial value. Whether or not this method represents the best method is determined using the factors set forth in Regulation 102.5 above.

Example 1: Adib owns all of the issued stock of Company A, an Uzbek corporation, and Company B, an Afghan corporation. Company A sells electric generators to Company B. Company B then sells the electric generators to customers in Afghanistan. Company B charges Afs. 20,000 per generator. Company B purchases the generators from Company A for Afs. 18,000 per generator. The applicable sales price for the generator is Afs. 20,000. The gross margin earned by Company B is Afs. 2,000 (Afs. 20,000 – Afs. 18,000). The gross margin percentage is 10%.

Example 2: The facts are the same as Example 1, except that the Afghanistan Revenue Department determines that Company B's competitors purchase generators from unconnected companies. The Afghanistan Revenue Department also determines that these companies earn the following gross margin percentages:

<i>Company C</i>	<i>12%</i>
<i>Company D</i>	<i>15%</i>
<i>Company E</i>	<i>18%</i>
<i>Company F</i>	<i>22%</i>

Because there are differences between the products sold by Companies C, D, E and F, that cannot be corrected for, the percentages above 12% and below 22% represent the relevant range of gross margins that Company B should earn with respect to the generators. Thus, the Afghanistan Revenue Department is entitled to adjust the transfer price between Company A and Company B to ensure that Company B earns a gross margin of at least 12%.

(c) Cost-Plus Method. The Cost-Plus Method is used to determine the appropriate transfer price by looking at the amount by which the sales price of property exceeds the cost to produce the property. This excess is referred to as the "markup". The "markup percentage" is the ratio of this excess markup over the costs of producing the property. This method is usually used in cases involving the manufacture, assembly or other

production of goods that are sold to connected parties. The Cost-Plus Method is used to determine an appropriate price by adding the appropriate gross profit to the connected taxpayer's cost for producing the property involved in the connected transaction. The appropriate gross profit is computed by looking at the markup percentage earned in unconnected transactions.

Example 1: *Wahid owns all of the issued stock of Company A, an Afghan corporation, and Company B, a British corporation. Company A makes carpets in Afghanistan and sells them to Company B. Company B sells the carpets to customers in Britain. Company A sells the carpets to Company B for Afs. 30,000 per carpet. It costs Company A Afs. 25,000 to make each carpet. The mark-up earned by Company A is Afs. 5,000. The markup percentage is 20% (Afs. 5,000 / Afs. 25,000).*

Example 2: *The facts are the same as in Example 1, except that the Afghanistan Revenue Department identifies three other Afghan carpet manufacturers in the same geographic location. These manufacturers sell very similar carpets to unconnected companies in Europe. The Afghanistan Revenue Department determines that these three manufacturers incur costs that are similar to Company A. These other companies earn different mark-up percentages, however:*

<i>Company C</i>	<i>16%</i>
<i>Company D</i>	<i>22%</i>
<i>Company E</i>	<i>23%</i>

The Afghanistan Revenue Department determines that Companies C, D, and E are all providing very similar goods on terms that are very similar to the terms offered by Company A. Thus, all three of the foregoing results create a range of reasonable results. Because the markup percentage earned by Company A is within this range, no adjustment should be made.

Example 3: *The facts are the same as in Example 2, but the Afghanistan Revenue Department discovers four potential unconnected transactions. These transactions are very similar to the transactions conducted by Company A, but there are differences. For example, some of the carpets sold in the unconnected transactions are not made of 100% sheep's wool. The Afghanistan Revenue Department does not believe that it can make adequate adjustments to the unconnected transactions to make them more similar to Company A's sales to Company B. The applicable markup percentages are set forth below:*

<i>Company F</i>	<i>15%</i>
<i>Company G</i>	<i>18%</i>
<i>Company H</i>	<i>21%</i>
<i>Company I</i>	<i>24%</i>

Because these unconnected transactions are not sufficiently similar to Company A's sales of carpets to Company B, the Afghanistan Revenue Department has to create a reasonable range of results. The reasonable range of results excludes the lowest 25% of the results and the highest 25% of results from the unconnected transactions. In the foregoing list of results, the lowest result is 15% and the highest result is 24%. Thus, the range of reasonable results is above 15% but below 24%. The Afghanistan Revenue Department may adjust the transfer price between Company A and Company B so that Company A's mark-up is above 15% but below 24%.

(d) Transactional Net Margin Method. The Transactional Net Margin method can be used for transfers of tangible and intangible property. Thus, the rules regarding the Transactional Net Margin Method are described separately in Regulation 102.14.

(e) Unspecified Methods. Unspecified Methods can be used for transfers of tangible and intangible property. Thus, the rules regarding unspecified methods are described separately in Regulation 102.15.

102.13 The method for determining an appropriate charge for the sale or transfer of intangible property is set forth in this regulation. Determining the appropriate transfer price for the sale or transfer of an intangible can be very difficult. Determining the appropriate transfer price is made complicated by the fact that the right to use an intangible can be separated into a number of different parts. Thus, a single item of intangible property can have multiple owners. For example, one person could have the right to use a specific name to sell carpets in Helmand province and someone else could have the right to use the exact same name to sell carpets in Bamiyan province. Thus, the first task in analyzing the transfer price for intangible property is to determine the owner of the property. Normally, if the intangible property is legally protected, the legal owner of the intangible property will be considered the owner, unless that person transfers substantially all of their rights to someone else pursuant to a contract.

The following examples assume that Afghan law provides one person with the sole legal right to use a particular name in the conduct of a trade or business for a province. The examples are for illustration only and should not be interpreted as a comment on the intangible property laws within Afghanistan.

Example 1: *Afghan law provides Azziz with the exclusive right to use the name "Afghan Carpets" in the Helmand and Bamiyan provinces. As a result, Azziz can open carpet stores in Helmand and Bamiyan with the name "Afghan Carpets" but no one else is permitted to open a carpet store with the same name. Azziz would normally be considered to own the intangible right to use that name in his business in those provinces for tax purposes.*

Example 2: *The facts are the same as in Example 1, except that Azziz enters into a contract with Wahid. The contract provides that Azziz will transfer all substantial rights in the name “Afghan Carpets” to Wahid for the Bamiyan province in exchange for Afs. 1,000,000. Thereafter, Azziz will be the only person permitted to use the name “Afghan Carpets” in Helmand province and Wahid will be the only person permitted to use the name “Afghan Carpets” in Bamiyan province. In this case, Azziz will only be considered the owner of the intangible in Helmand province. Wahid will be considered the owner of the intangible in Bamiyan province.*

If the intangible property is not legally protected, then the person that developed the intangible property will be considered to own the intangible property. If two or more connected persons develop the property, then the owner will be that person that bore the largest portion of the direct and indirect costs associated with the property.

Example 3: *Azziz owns all of the issued stock of Company A and Company B. Company A is an Afghan corporation. Company B is an Uzbek corporation. Employees from Company A and Company B work together to develop a new process for applying colored dye to cloth. At the time the process is developed, Afghanistan does not have a law that would provide Company A or Company B any legal protection for the new process. Hence, both Company A and Company B need to ensure that their employees do not tell other people about their new secret process. They both enter into contracts with their employees to try and protect the secrecy of the process. Company A incurred Afs. 3,000,000 in developing the secret process and Company B incurred Afs. 2,800,000 in developing the secret process. Company A should be considered to own the secret process.*

It is important to determine the owner of the intangible property because the owner of the property is the person that is entitled to receive compensation for the use of the intangible. The other parties that assisted in the development of the intangible are only compensated for their services.

Example 4: *The facts are the same as in the previous example. Because Company A is the owner of the process, Company A should pay Company B to reimburse Company B for its costs plus a reasonable profit. Company A needs to make this payment, because Company B provided services for Company A. If Company B uses the process in its business, Company B must pay Company A for the use of the process.*

Once the owner has been determined, the Afghanistan Revenue Department must use a transfer pricing method in order to determine whether the transfer price for the intangible property is appropriate. In summary, there are three acceptable methods for determining the appropriate price for the transfer of intangible property. These methods are the Comparable Unconnected Transaction Method, the Transactional Net Margin Method and Unspecified Methods.

- (a) Comparable Unconnected Transaction Method. The purpose of the Comparable Unconnected Transaction Method is to determine whether the amount charged between two connected persons for the transfer of an intangible property is reasonable by comparing that charge to the amount that would be charged in a similar transaction between two unconnected persons. This method is typically only used when a very similar transaction between unrelated persons can be found.

Example 1: Azziz owns the right to use the name “Afghan Carpets” in Helmand province and Bamiyan province. He grants Wahid the right to use the name in Helmand in exchange for a fee equal to 5% of Wahid’s carpet sales every year for the next six years. At the same time, Azziz grants his son, Adib, the right to use the same name in Bamiyan province in exchange for a fee of 3% of Adib’s carpet sales every year for the next six years. The Afghanistan Revenue Department determines that there is no significant reason why the right to use the name “Afghan Carpets” is any more valuable or any less valuable in Helmand province than Bamiyan province. Thus, the Afghanistan Revenue Department has the right to adjust Azziz’s income upward to reflect the fact that Azziz should be receiving an amount equal to 5% of his son’s carpet sales.

Example 2: Azziz owns all of the issued stock of Company A and Company B. Company A is an Afghan corporation. Company B is a Canadian corporation. Company A puts soda into bottles for sale in Afghanistan. To perform its business, Company A imports bottles and syrup from outside of Afghanistan. Company A then takes the bottles and syrup and converts them into soda for sale in the markets. Company B owns the rights to a secret process that makes it easier to put soda into plastic bottles. Company B grants the right to use this process to Company A in exchange for a fee equal to 5% of Company A’s revenues. Company C is unconnected to Azziz, Company A and Company B. Company C owns the right to use the name “Afghan Cola” in Afghanistan. Company C grants Company A the right to use this name when Company A puts labels on the bottles that it sells. Company C charges Company A a fee equal to 1% of Company A’s revenues. The right to use a secret process and the right to use a name are completely different rights. Thus, the Afghanistan Revenue Department cannot use the Comparable Unconnected Transaction Method to decrease the fee paid by Company A to Company B to 1% of net revenue, and thereby increase Company A’s profits.

- (b) Transactional Net Margin Method. The Transactional Net Margin Method can be used for transfers of tangible and intangible property. Thus, the rules regarding the Transactional Net Margin Method are described separately in Regulation 102.14.

- (c) Unspecified Methods. Unspecified Methods can be used for transfers of tangible and intangible property. Thus, the rules regarding the unspecified methods are described separately in Regulation 102.15.

102.14 Transactional Net Margin Method. The Transactional Net Margin Method is used to determine whether the amount charged in a connected transaction is reasonable based on objective measures of profitability. The Transactional Net Margin Method can be used for transfers of tangible and intangible property. These objective measures of profitability are often referred to as "Profit Level Indicators". These Profit Level Indicators are derived from an investigation of transactions occurring between unconnected taxpayers that engage in similar business activities under similar circumstances. This method should only be used if the other methods described above cannot be used.

Example 1: The Afghanistan Revenue Department reviews the profits earned by automobile sellers in Kabul, Herat, and Mazar-e-Sharif, for the past three years. The department learns that a typical businessman's profit from the sale of automobiles to customers will equal between 3% of his sales revenue and 10% of his sales revenue. Thus, if the sales price for an automobile is Afs. 100,000, the businessman's profit from that sale is between Afs. 3,000 and Afs. 10,000. This ratio of profit to revenue is a Profit Level Indicator.

Under the Transactional Net Margin Method, a reasonable profit margin is determined by applying the Profit Level Indicator that was derived from unconnected parties to the transactions under investigation.

Example 2: The facts are the same as in the previous example, except that the taxpayer under investigation is Wahid. Wahid owns and operates a business in Kabul that sells used automobiles to customers. One of Wahid's most significant customers is his son, Adib. Adib owns a company in Kabul that provides security. Adib purchases all of his vehicles from his father's business. The Afghanistan Revenue Department discovered that the ratio of Wahid's profit to his revenue from selling cars to his son is typically less than 1%. The Afghanistan Revenue Department can use the information it derived from unconnected transactions in Kabul, Herat and Mazar-e-Sharif to increase Wahid's profit from the sale of cars to his son until the ratio of the profit that Wahid earns to the revenue that Wahid earns is between 3% and 10%.

Many different ratios can be considered Profit Level Indicators. For example, the ratio of profit to revenue is one type of Profit Level Indicator. Another Profit Level Indicator is the ratio of operating profit to operating expenses. It is important to attempt to isolate the profit with respect to a particular transaction, rather than the profit generated by an entire company.

Example 3: Azziz owns a store in Pakistan that makes cloth. Azziz sells the cloth to his son, Adib, who lives in Afghanistan. Adib uses the cloth to make suits for men. Adib sells these suits in his store located in the Shar-e-Now area of Kabul. The Afghanistan Revenue Department investigates Adib for the tax year 1387. The Afghanistan Revenue Department learns that Adib earned the following profit during the year 1387:

Revenue	Afs. 10,000,000
Cost of Goods Sold	- 8,000,000
Gross Profit	2,000,000
Operating Expenses	- 1,000,000
Net Profit	<u>1,000,000</u>

The foregoing information can provide a number of different Profit Level Indicators. For example, the ratio of net profit to revenue is 10%. Razique is unconnected to Azziz and Adib. Razique also owns a store in Shar-e-Now. The Afghanistan Revenue Department knows, from reviewing the tax returns of Razique for the last four years, that Razique's ratio of net profit to revenue is approximately 5%. Unlike Adib, however, Razique sells men's suits, and shoes and various Afghan crafts. The Afghanistan Revenue Department cannot determine what profit Razique earns only on the sale of suits. Thus, the Afghanistan Revenue Department should not use Razique's results to adjust Adib's profit under the Transactional Net Margin Method.

To enhance the accuracy of the method, a number of years of data should be reviewed. Generally, at least three years of data should be analyzed to develop a Profit Level Indicator.

Example 4: The Afghanistan Revenue Department wants to determine what a reasonable profit should be for the sale of used automobiles so that it can develop a Profit Level Indicator. The Department obtains information for two companies, Company A and Company B. Company A has the following information:

<u>Year</u>	<u>Revenue</u>	<u>Profit</u>	<u>Ratio</u>
1386	1,000,000	100,000	1%
1387	2,000,000	200,000	1%
1388	5,000,000	500,000	10%

The Afghanistan Revenue Department should take the average of the results for the past three years, or 4% (1% + 1% + 10%)/3. The Afghanistan Revenue Department should not simply take the 10% figure from 1388 because it is the highest figure.

Company B has the following information:

<u>Year</u>	<u>Revenue</u>	<u>Profit</u>	<u>Ratio</u>
1386	1,000,000	200,000	2%
1387	2,000,000	200,000	1%
1388	5,000,000	300,000	6%

The Afghanistan Revenue Department should take the average of the results for the past three years, or 3% (2% + 1% + 6%)/3.

The Afghanistan Revenue Department should take the same steps with other companies that it believes engage in similar activities in order to develop a reasonable range of Profit Level Indicators as required under Regulation 102.7.

In addition, it is important to ensure that the businesses that are analyzed to develop the reasonable range of Profit Level Indicators use the same methods of accounting.

Example 5: *Azziz owns a store in the Wazir Akbar Khan area of Kabul. The store sells breads and cookies and pastries. Azziz uses the cash method of accounting. Azziz buys all of his flour from his son, who owns a store in Pakistan. If the Afghanistan Revenue Department wants to use the Transactional Net Margin Method to investigate the transfer price that Azziz pays for flour, it must find a similar transaction between unconnected parties who use the cash basis of accounting.*

As noted above, the Transactional Net Margin Method can be used to establish an arm's length price on transfers of tangible or intangible property.

Example 6: *Najibullah is an Afghan citizen and resident that owns all of the issued stock of a Canadian corporation and an Afghan corporation. The Canadian corporation licenses the Afghan corporation the right to use certain technology in the Afghan corporation's business of manufacturing steel. The Afghan corporation pays a royalty to the Canadian corporation during the year 1390. The payment of the royalty is the only connected transaction between the Afghan corporation and the Canadian corporation. The royalty equals 8% of the Afghan corporation's sales revenue. The Afghanistan Revenue Department chooses net profit as a percentage of sales as its profit level indicator. The Afghanistan Revenue Department reviews the net profits and sales revenues earned during the last three years for each of four companies. The results are as follows:*

<u>Company</u>	<u>Year</u>	<u>Profits/Sales</u>
Company A	1389	6%
	1388	5%
	1387	7%
	Average	6%

<i>Company B</i>	<i>1389</i>	<i>5%</i>
	<i>1388</i>	<i>2%</i>
	<i>1387</i>	<i>8%</i>
	<i>Average</i>	<i>5%</i>
<i>Company C</i>	<i>1389</i>	<i>2%</i>
	<i>1388</i>	<i>4%</i>
	<i>1387</i>	<i>0%</i>
	<i>Average</i>	<i>2%</i>
<i>Company D</i>	<i>1389</i>	<i>2%</i>
	<i>1388</i>	<i>1%</i>
	<i>1387</i>	<i>0%</i>
	<i>Average</i>	<i>1%</i>

Company D's average 1% profit margin represents the bottom 25% of results. Company A's average 6% profit margin represents the top 25% of results. To the extent the Afghan corporation generates a ratio of profits to sales above 1% but below 6%, the royalty it pays to the Canadian corporation should not be adjusted.

Assume that the Afghan corporation generates a loss in 1390. The Afghanistan Revenue Department can reduce the royalty that the Afghan corporation pays the Canadian corporation until the Afghan corporation's ratio of profits to sales exceeds 1%.

102.15 Unspecified Methods. The Afghanistan Revenue Department and taxpayers may both use methods that are not described above to determine the appropriate transfer price in a connected transaction. In the event that one of the specified methods (mentioned above) and an unspecified method can be used, the specified method is preferred. Like the Transactional Net Margin Method, Unspecified Methods can be used to determine the arm's length price for transfers of tangible and intangible property.

Example 1: *Wahid owns all of the issued stock of Company A and Company B. Company A is an Afghan corporation. Company B is a Pakistani corporation. Company A supplies lapis stone to Company B. Company B takes the lapis stone and transforms it into jewelry. Company B then sells the jewelry throughout the world. Company A only sells lapis stone to Company B. Company A does not sell lapis stone to any other unconnected person. Company A does not have enough information to use one of the specified methods to determine what the appropriate transfer price should be between Company A and Company B. The Afghanistan Revenue Department does not have enough information to use one of the specified methods. Company A has received an offer from Company C, an unconnected Pakistani company, to purchase lapis stone for Afs. 90,000 per kilogram. This*

offer from the Pakistani company is not considered an “unconnected transaction” because it is only a bid. It does not represent a completed transaction. Because one of the specified methods above cannot be used, Company A and the Afghanistan Revenue Department can both rely on this offer from Company C to determine what the appropriate transfer price should be.

Example 2: *Wahid owns all of the issued stock of a Canadian corporation and an Afghan corporation. The Canadian corporation licenses certain technology to the Afghan corporation in exchange for an annual royalty equal to 8% of the Afghan corporation’s net sales. The Afghan corporation is in the business of manufacturing steel. The Afghanistan Revenue Department attempts to apply the Comparable Uncontrolled Transaction Method, but it cannot find a reasonable comparable unconnected transaction. The Afghanistan Revenue Department attempts to apply the Transactional Net Margin Method, but it cannot obtain financial information about unconnected corporations in the same business as the Afghan corporation. If it is impossible to apply one of the specified methods, both the Afghanistan Revenue Department and the Afghan corporation can look at the profit level indicators generated by unconnected companies in related businesses to determine whether the Afghan corporation’s profits are appropriate. For example, they could look at the profits earned by businesses that manufacture concrete or bricks or other building materials.*

Anti-avoidance

- Article 103 (1) Where any person enters into any transaction or arrangement or series of transactions or arrangements that have as the main object or main effect a reduction of liability to pay income tax, the Ministry of Finance may disregard such transaction or arrangement and assess all persons affected by the transaction or arrangement as if the disregarded transaction or arrangement had not taken place.
- (2) Any person who evades income tax will be required to pay the income tax due and:
- in the first instance, additional tax of double the evaded tax, and
 - in the second instance, additional tax of double the evaded tax and the business activity of the person shall be ceased by order of the court.

103.1 The anti-avoidance rule in Article 103 can only be applied if the taxpayer enters into a transaction and the most significant result of the transaction is to reduce the taxpayer's income tax liability.

103.2 To apply Article 103, it is necessary for the Afghanistan Revenue Department to demonstrate that the taxpayer's tax liability was reduced by the transaction. Nevertheless, it is not sufficient for the Afghanistan Revenue Department to establish only that the taxpayer's tax liability was reduced.

Example 1: *Company A is an Afghan corporation. Company A is engaged in the business of providing telecommunications services to customers throughout Afghanistan. During the year 1387 Company A generates a loss of Afs. 50,000,000. During the year 1388, Company A uses the Afs. 50,000,000 loss from the year 1387 to reduce its taxable profit and its tax liability. Article 103 should not be applied in this situation. It is true that Company A engaged in transactions during the tax year 1387 which had the effect of reducing Company A's tax liability in 1388. Nevertheless, the primary purpose of Company A's transactions during 1387 was to provide telecommunications services to customers. The primary purpose was not to achieve a tax benefit.*

Example 2: *Azziz is an individual who needs to use land and a building for his business in Herat. Azziz knows that if he purchases the land and the building, he will be able to claim depreciation deductions for the building. Azziz also knows that he will not be able to claim depreciation deductions for the land. Azziz knows that if he chooses to rent the land and the building, he will be able to claim a deduction for the entire rental payment. Thus, Azziz decides that he should rent the land and the building. Article 103 should not apply in this case. Azziz's primary purpose in renting the building was to do his business*

in Herat. The fact that renting the land and building creates more of a tax benefit than purchasing the land and the building is not sufficient reason to apply Article 103.

- 103.3 Before Article 103 can be applied, the Afghanistan Revenue Department must also be able to prove that the taxpayer's intention to reduce taxes was the primary reason that the taxpayer chose to enter into the transaction. The taxpayer's intention is determined by looking at the facts surrounding the transaction, and not the taxpayer's personal testimony.

Example 1: *Wahid owns all of the stock of Company A and Company B. Company A and Company B are both Afghan corporations. Company A is not registered under the Private Investment Law of Afghanistan. Thus, Company A is not able to carry forward its tax losses indefinitely. Company A believes that, in the tax year 1388, one of its tax losses will expire. To prevent the loss from expiring unused, Company A sells an asset to Company B on the last day of 1388. Company A recognizes a gain on the sale. Company A uses its tax loss to reduce the amount of gain it recognized during 1388. On the first day of Hamal, 1389, Company B sells the same asset to Company A. Thus, Company A owned the asset before this transaction. Company A owned the asset after this transaction. Company A was able to use its tax loss. Company A was also able to increase the depreciation basis of the asset to fair market value without paying any tax. Company A can now claim larger depreciation deductions with respect to the asset, and lower its tax liability. The sole reason for this transaction is to reduce Company A's tax liability. If the tax consequences were not considered, Company A would not want to sell the asset to Company B and Company B would not want to buy the asset from Company A. It is therefore appropriate for the Afghanistan Revenue Department to apply Article 103 in this situation.*

Example 2: *Wahid owns all of the stock of Company A. Company A is an Afghan corporation. Company A is in the business of manufacturing and selling ceramic plates, jugs and cups. Company A employs 20 of Wahid's cousins. All of these cousins are less than 15 years old. Wahid pays these cousins Afs. 12,500 per month for services that they perform. Because the amounts paid to each cousin is only Afs. 12,500 per month, none of the amounts paid are subject to wage withholding. Nevertheless, Company A claims a deduction for the Afs. 12,500 that is paid to each cousin. The Afghanistan Revenue Department investigates Company A. Wahid tells the Afghanistan Revenue Department that he employs his cousins because they are good workers. Nevertheless, the Afghanistan Revenue Department discovers that many of these cousins are too young to work. Moreover, Wahid is unable to prove that the cousins actually perform services for Company A. It is appropriate for the Afghanistan Revenue Department to apply Article 103 and disregard the payments to the cousins.*

- 103.4 The first time Article 103(2) is applied to a taxpayer that is a natural or legal person, the taxpayer must pay the additional tax that is owed. The taxpayer must also pay a penalty equal to two times the additional amount of tax that is owed.
- 103.5 The second time Article 103(2) is applied to a taxpayer that is a natural or legal person, the taxpayer must pay the additional tax that is owed. The taxpayer must also pay a penalty equal to two times the additional amount of tax that is owed. In addition, the Afghanistan Revenue Department may choose to apply to the commercial court (*maqima tejurat*) for an order to close down the taxpayer's business. Before pursuing the order, the following requirements should be satisfied:
- (a) the Afghanistan Revenue Department personnel who are involved with the taxpayer's file should consider the seriousness of the taxpayer's offenses.
 - (b) the Afghanistan Revenue Department should consider whether the amounts involved justify closing down a taxpayer's business.
 - (c) the Afghanistan Revenue Department should consider whether the taxpayer has taken any actions to prevent tax evasion in the future.
 - (d) authorized Afghanistan Revenue Department personnel should decide whether they want to request a temporary business closure or a permanent business closure.
 - (e) the responsible persons should file their request for closure with the commercial court (*maqima tejurat*).
 - (f) if the court order is granted, the responsible persons should take the steps necessary to enforce the order. Enforcement should involve contacting the Ministry of Interior.

CHAPTER XVI

ADDITIONAL TAX AND TAX PENALTIES

Article 104 – Article 112

Offenses and Penalties

- Article 104 (1) A taxpayer may incur an additional income tax liability and penalties under this Chapter in addition to tax due if the taxpayer has not complied with tax obligations set out in the provisions of this Law. The provisions of this Law apply to the assessment and collection of additional income tax in the same manner as for other tax under this Law.
- (2) Additional income tax is payable in the following situations:
1. failure to pay the due tax by the due date,
 2. failure to maintain or provide access to records of business transactions,
 3. failure to deliver a tax return,
 4. failure to withhold tax,
 5. failure to pay tax,
 6. failure to obtain a Tax Identification Number.

104.1 Chapter 16 provides for additional tax and penalties where there has been non-compliance with this Law. Additional tax and penalties may be imposed and collected according to the same provisions as apply to taxes imposed by this Law. That is, additional tax and penalty may be levied according to the provisions of Chapter 13 regarding assessment and payment of taxes and collected according to the provisions of Chapter 14 regarding the enforcement of tax payments.

104.2 Paragraph 2 of Article 104 lists the situations where non-compliance with this Law may result in additional tax and penalties being payable. Each of the situations listed is dealt with in more detail in the remaining Articles of this Chapter.

Additional income tax where tax is paid late

Article 105 Where a person has failed to pay tax due by the due date, the person is liable to pay additional income tax of 0.10 per cent of the tax due per day.

105.1 The Income Tax Law imposes an additional tax of 0.10 per cent of any amount of tax that is not paid by its due date. This additional tax applies even if the tax return is filed on time.

Example 1: *Adib owns all of the issued stock of Company A. Company A is an Afghan corporation. Company A is required to file its income tax return for the 1386 year by the last day of Jawza, 1387. Company A is required to pay the tax that is due with the return. Company A does not file its income tax return until 10 days after the end of Jawza. The income tax liability shown on the return is Afs. 100,000. If Company A pays the Afs. 100,000 on the date that is 10 days after the end of Jawza, the company will owe penalties of Afs. 1,000 (Afs. 100,000 x 0.001 (= 0.1 per cent) x 10 days).*

Example 2: *The facts are the same as in Example 1, except that Company A files its tax return on the last day of Jawza. As the tax was not paid until 10 days after the end of Jawza, the additional tax for late payment of tax is the same as in Example 1. The fact that Company A filed its tax return (but did not pay) on time is not relevant.*

105.2 The additional tax in Article 105 applies to any unpaid tax liability, including the business receipts tax or fixed taxes imposed in lieu of income taxes.

105.3 The Afghanistan Revenue Department may refrain from applying the 0.10 per cent per day additional tax imposed under Article 105 where the additional tax is less than Afs. 250. The Afs. 250 threshold may be applied separately to different tax types.

Example: *Haroon runs a restaurant in Herat. In respect of the 1388 year, the restaurant has gross receipts of 2,000,000 Afs and makes a profit after deducting expenses of 160,000 Afs. Haroon is required to pay income tax (by the last day of Jawza 1388) and business receipts tax (by the 15th day following the end of each quarter). Haroon inadvertently misses making these tax payments by their due dates but only by a few days. If the 0.01 per cent additional tax calculated under this Article would be 200 afghanis in respect of income tax and 100 afghanis in respect of business receipts tax, the Ministry of Finance can refrain from applying both amounts, despite their total being above the 250 Afs. threshold.*

105.4 The Afghanistan Revenue Department may refrain from applying the 0.01 per cent per day additional tax imposed under Article 105 for amounts up to Afs. 500,000 additional tax where the following requirements are satisfied:

- a) An additional tax assessment has been issued.
- b) The taxpayer has requested that the additional tax should not be applied and the request sets forth facts supporting the taxpayer's attempt to comply with this Law in good faith.
- c) The Director-General of Revenue, or a Deputy Director-General of Revenue has requested the Deputy Minister for Revenue and Customs in writing to refrain from applying the additional tax. Any such request shall require a consideration of the taxpayer's entire tax compliance history and be made only where a determination has been made that the taxpayer has made a good faith effort to comply with this Law.
- d) The Deputy Minister for Revenue and Customs has agreed that the additional tax should not be applied.

Additional income tax where records were not maintained

- Article 106
- (1) A person who fails without reasonable cause to establish and maintain records required by the provisions of this Law or fails to provide access to records by Ministry of Finance officers, shall pay additional income tax of 5,000 afghanis if the person is a natural person or 20,000 afghanis if the person is a legal person.
 - (2) A person who fails to establish and maintain records as required as a result of gross negligence or disregard shall pay additional income tax of 10,000 afghanis if the person is a natural person or 40,000 afghanis if the person is a legal person.
 - (3) A person who deliberately fails to establish and maintain records or fails to provide access to records by Ministry of Finance officers shall pay additional income tax of 30,000 afghanis if the person is a natural person or 120,000 afghanis if the person is a legal person.
 - (4) A person who fails to establish and maintain records as required by the provisions of this Law with the intent of evading payment of tax, in addition to the payment of an additional tax under paragraph (3) of this Article, shall be guilty of an offence and is liable upon conviction by a court to a fine not exceeding 250,000 afghanis or imprisonment for a term not exceeding two years or both.

106.1 A natural person may be subject to Afs. 5,000 additional tax and a legal person may be subject to a Afs. 20,000 additional tax where all the following circumstances apply:

- (a) The natural person or the legal person was required to maintain records under this Income Tax Law.
- (b) The natural person or the legal person failed to maintain appropriate or reasonable records OR the natural or legal person failed to provide Ministry of Finance, Afghanistan Revenue Department officers with access to its records.
- (c) The natural person or the legal person did not have a reasonable justification or excuse for failing to maintain the appropriate records OR failing to provide Ministry of Finance Afghanistan Revenue Department officers with access to its records.

Example 1: *Company A operates a large business in Kabul province. Company A keeps a record of its revenues, but it does not keep a record of its expenses. Company A files an income tax return that shows Afs. 1,000,000 of revenue and Afs. 800,000 of expenses. Company A is required to maintain records under Article 36 of the Income Tax Law. When the Afghanistan Revenue Department asks Company A why it failed to keep records of its expenses, the management of Company A*

said that it was not aware of the requirement. Even if Company A had never been audited or contacted by the Afghanistan Revenue Department before, Company A does not have a justifiable reason for failing to keep the appropriate records. Company A is expected to be aware of the requirements of the Income Tax Law (including those relating to record-keeping) as would any reasonable business person. Company A is subject to the Afs. 5,000 additional tax.

Example 2: *Azziz owns a warehouse in Kabul. During 1387, Azziz's warehouse is destroyed by a fire. Azziz takes a deduction for the cost of his warehouse under Article 18 (1) 9 during 1387. Article 18 (1) 9 provides that in order to claim the deduction Azziz is required to have proper records, including records that show how much Azziz's warehouse cost. When Azziz is asked for the documentation that supports the cost of his warehouse, Azziz replies that he does not have any records. Azziz says that the reason that he does not have any records is that all of his records were in the warehouse that was destroyed by the fire. Azziz has a justifiable reason for failing to keep the appropriate records. Azziz is not subject to an Article 106 additional tax.*

Example 3: *Officers from the Afghanistan Revenue Department visit the business premises of Company A and request to inspect contract documents which are known to be held in Company A's office. The officers show the manager a copy of Article 106 of the Income Tax Law which authorizes the officers take this action. The manager denies the officers access to the documents on the basis that, in his opinion, only a court can compel him to allow access to Company A's business records and that Company A's confidential information may be given to its competitors. The manager's belief is unreasonable since the Income Tax Law, a validly enacted law of Afghanistan, clearly allows access to records without a court order. Further, the Income Tax Law treats information collected by revenue officers as confidential and prevents disclosure of such information to anyone outside the Ministry of Finance unless authorized by law. The manager does not have reasonable cause to deny access to Company A's records. Additional tax of Afs 20,000 may be assessed to Company A.*

106.2 A natural person may be subject to Afs. 10,000 additional tax and a legal person may be subject to Afs. 40,000 additional tax where all the following circumstances apply:

- (a) The natural person or the legal person was required to maintain records under this Income Tax Law.
- (b) The natural person or the legal person failed to maintain appropriate or reasonable records.
- (c) The natural person or legal person acted in a way that was grossly negligent. A person is grossly negligent if they fail to take the same

amount of care that a reasonable person would take under similar circumstances.

Example: *Azziz is an individual that operates an electrical contractor business in the city of Kabul. Azziz files an income tax return that shows Afs. 1,000,000 of revenue and Afs. 800,000 of expenses. Azziz is required to maintain records under Article 36 of the Income Tax Law. Azziz knows that he is required to maintain records under Article 36 of the Income Tax Law. Azziz does not have any records to support his revenue or his expense figures. When the Afghanistan Revenue Department asks Azziz why he failed to keep records of his expenses, Azziz said that he kept the records in the trunk of his automobile. The automobile was stolen in the month of Saratan. A reasonable businessman would not store his business records in the trunk of his car. The fact that Azziz stored his records in the trunk of his car is evidence that Azziz acted with gross negligence. Azziz is subject to the Afs. 10,000 additional tax.*

106.3 A natural person may be subject to Afs. 30,000 additional tax and a legal person may be subject to Afs. 120,000 additional tax where all the following circumstances apply:

- (a) The natural person or the legal person was required to maintain records under this Income Tax Law.
- (b) The natural person or the legal person failed to maintain appropriate or reasonable records OR the natural or legal person failed to provide Ministry of Finance Afghanistan Revenue Department officers with access to its records.
- (c) The natural person or legal person intentionally failed to maintain the records that were required OR intentionally failed to provide Ministry of Finance Afghanistan Revenue Department officers with access to its records.

Example: *Azziz operates a plumbing business in Kabul. Azziz was audited during the tax year 1387. During the audit for the tax year 1387, the Afghanistan Revenue Department warned Azziz that he needs to prepare and maintain business records. During the tax year 1389, Azziz is audited again. Azziz does not have any records to support his expenses and he only has partial records to support his revenues. When the Afghanistan Revenue Department asks Azziz why he failed to maintain these records, Azziz simply says that keeping the records is too difficult. Azziz failed to keep adequate records. Azziz knew that he was required to maintain records but he chose not to maintain the records. Azziz may be subject to Afs. 30,000 additional tax.*

Example: *Officers from the Afghanistan Revenue Department visit the business premises of Company A and request to inspect contract documents which are known to be held in Company A's office. The officers show*

the manager a copy of Article 106 of the Income Tax Law which authorizes the officers take this action. The manager refuses to provide access to the records because he knows that there is information in the contract documents which will show that Company A's income tax has been understated. When asked by the officers why he will not provide access to the records, the manager gives no reason. Company A may be subject to Afs 120,000 additional tax for deliberate failure to provide access to records.

106.4 A person may be subject to conviction by a court to a fine up to Afs. 250,000 and/or imprisonment up to 2 years in addition to the applicable penalties under Regulation 106.3 where all the following circumstances apply:

- (a) The natural person or the legal person was required to maintain records under this Income Tax Law.
- (b) The natural person or the legal person failed to maintain appropriate records.
- (c) The natural person or legal person intentionally failed to maintain the records that were required, because the natural person or legal person wanted to to evade paying tax.

The fine and imprisonment penalties imposed under Article 106(4) cannot be imposed unless or until a court concludes that the taxpayer is guilty of intentionally refusing to maintain records in order to reduce their tax liability. The Afghanistan Revenue Department cannot impose the penalties in Article 106(4) without an order from the court. Thus, if Afghanistan Revenue Department personnel determine that Article 106(4) applies, they should contact the Attorney General's Office (Saranwali) so that prosecution action can be commenced.

Example 1: *Company A is an Afghan corporation. Company A provides security services to various customers throughout Afghanistan. Company A has two bank accounts. Company A has one bank account with a bank in Afghanistan. Company A has another bank account with a bank in Pakistan. The Afghanistan Revenue Department audits Company A for the tax year 1387. During the audit, the Afghanistan Revenue Department learns that Company A deliberately asked customers to transfer money to the Pakistani bank account. Company A did not record the monies that were transferred to Pakistan as revenue even though the money related to services that Company A performed in Afghanistan. The Company did not maintain any records of the revenues that were earned from these contracts. In this case, Company A failed to maintain adequate records of its revenues. Company A failed to record the revenue in order to avoid paying the tax that it was required to pay in Afghanistan. The Afghanistan Revenue Department may refer this case to the Ministry of Justice for prosecution under Article 106(4).*

Example 2: *Company A is an Afghan corporation. Company A provides security services to various clients throughout Afghanistan. During the year 1387, Company A claims that it has Afs. 1,000,000 of revenue and Afs. 900,000 of expenses. The Afghanistan Revenue Department learns, upon auditing Company A, that Company A created invoices to justify Afs. 250,000 of expenses that did not exist. Company A created these false invoices in order to lower its income tax liability. The Afghanistan Revenue Department may refer this case to the Ministry of Justice for prosecution under Article 106(4).*

Additional income tax where a tax return was not filed

- Article 107
- (1) A person who fails without reasonable cause to file a tax return by the due date shall pay additional income tax of 200 afghanis for each day other than holidays that the return is overdue if the person is a natural person or 1,000 afghanis for each day other than holidays that the return is overdue if the person is a legal person.
 - (2) A person who fails to file a tax return by the due date as a result of gross negligence or disregard shall pay additional income tax of 400 afghanis for each day other than holidays that the return is overdue if the person is a natural person or 2,000 afghanis for each day other than holidays that the return is overdue if the person is a legal person.
 - (3) A person who deliberately fails to file a tax return by the due date shall pay additional income tax of 800 afghanis for each day other than holidays that the return is overdue if the person is a natural person or 4,000 afghanis for each day other than holidays that the return is overdue if the person is a legal person.
 - (4) A person who fails to file a tax return by the due date with the intent of evading payment of tax, in addition to the payment of an additional tax under paragraph (3) of this Article, shall be guilty of an offence and is liable upon conviction by a court to a fine not exceeding 250,000 afghanis or imprisonment for a term not exceeding two years or both.

107.1 A natural person shall pay additional income tax of Afs. 200 and a legal person shall pay Afs. 1,000 for each day (other than holidays) that their tax return is filed after the due date required under the provisions of this law. This additional tax shall only apply if the taxpayer does not have reasonable justification for the failure to file their tax return in a timely manner.

Example 1: *Company A is an Afghan corporation. Company A is required to file its income tax return by the last day of Jawza, 1388. Company A does not file its tax return for the 1387 year until ten (10) days after the last day of Jawza during the tax year 1388. When the Afghanistan Revenue Department asks Company A why it failed to file its tax return on time, Company A personnel respond that they had trouble completing their financial statements. Company A does not have a reasonable excuse for not preparing and filing its tax return on time. Company A should be subject to the Afs. 1,000 per day additional tax.*

Example 2: *Company A is an Afghan corporation. Company A is required to file its tax return for the 1387 year on the last day of Jawza, 1388. Company A fails to file its tax return until the first day of Hamal, 1389. The reason Company A did not file its tax return on time is that its office burned down and all of its financial records were destroyed. Company A filed its tax return as soon as it was able to do so after the*

fire. Company A should not be subject to the Afs. 1,000 per day additional tax.

107.2 A person who fails to file a tax return by the due date required under the provisions of this Law as a result of gross negligence or disregard shall pay additional income tax of 400 Afs. for each day (other than holidays) that the return is overdue if the person is a natural person and 2,000 Afs. for each day (other than holidays) that the return is overdue if the person is a legal person. A natural person or a legal person acts with gross negligence if the person fails to act with the care expected of a reasonable person under similar circumstances.

Example 1: *Company A is an Afghan corporation that is required to file its tax return for the 1387 year by the last day of Jawza, 1388. Company A fails to file its return on time. Instead, Company A files its tax return forty (40) days later. Company A keeps its financial information locked in file cabinets within one of its buildings in Kabul. Company A failed to file its tax return on time because some of its financial records were stolen at the beginning of Jawza. It took company A a number of weeks to replace the stolen financial information. Company A should not be subject to the Afs. 2,000 per day additional tax.*

Example 2: *The facts are the same as in Example 1, except that Company A keeps its records in unlocked cabinets in an unlocked garage. Anyone can have access to the garage whenever they want. It is not reasonable for a business to keep its financial information in a place that is not locked. Company A should be subject to the Afs. 2,000 per day additional tax.*

107.3 A person who deliberately fails to file a tax return by the due date required under the provisions of this Law shall pay additional income tax of 800 Afs. for each day (other than holidays) that the return is overdue if the person is a natural person and 4,000 Afs. for each day (other than holidays) that the return is overdue if the person is a legal person.

Example: *Wahid is a United Kingdom citizen. Wahid is also an Afghan resident according to the Income Tax Law because he spends approximately 200 days per year within Afghanistan. Wahid has seen information on the Ministry of Finance's website which indicates that Wahid has to file a tax return in Afghanistan. Wahid is subject to tax in the United Kingdom on his worldwide income, including his income from Afghanistan sources. Wahid knows that if he pays tax in Afghanistan, he will be able to claim a credit for those taxes against his United Kingdom tax liability. Thus, Wahid does not refuse to file a tax return in order to evade paying his Afghan tax liability. Instead, Wahid fails to file a tax return, because it takes time to prepare the income tax form and Wahid believes he has better things to do with his time. As soon as the Afghanistan Revenue Department audits Wahid, Wahid agrees to file his return and pay the tax due. Wahid is subject to the Afs. 800 per day additional tax.*

- 107.4 A person who fails to file a tax return as required under the provisions of this law with the purpose of evading payment of tax, shall pay additional tax required under Article 107(3). In addition, the person may be convicted by a court order to a fine of up to Afs. 250,000 or imprisonment of up to two years or both. The fine/imprisonment additional tax under Article 107(4) cannot be imposed without a court order. If the Afghanistan Revenue Department believes that the Article 107(4) additional tax should apply, the Afghanistan Revenue Department should contact the Attorney General's Office (Saranwali) for referral to the court.

Example: *Azziz is a United States citizen, but is a resident of Afghanistan. Azziz has been a resident of Afghanistan during the tax years 1387, 1388 and 1389. Azziz knows that he is required to file an income tax return in Afghanistan because the Afghanistan Revenue Department advised Azziz in 1387 that he needed to file an income tax return. Azziz deliberately failed to listen to the Afghanistan Revenue Department's warning. Azziz also knows that if he pays tax in Afghanistan he will not be able to reduce his U.S. tax liability by an equal amount. Thus, every Afs. 1 Azziz pays to the Afghanistan government reduces Azziz's income for the year. Azziz chooses not to file a tax return because he wants to pay less tax in Afghanistan. The Afghanistan Revenue Department should assess the additional tax described in Article 107(3) and may refer the case to the Ministry of Justice for prosecution.*

- 107.5 The additional tax under Article 107 only applies if the tax return is filed late. The Afghanistan Revenue Department will not apply the Article 107 additional tax if the tax return is filed on time, even though it may be incorrect. If the tax return is not correct, the Afghanistan Revenue Department may consider whether the penalties under Articles 108 and 109 should apply.

Example: *Company A is an Afghan corporation that owns and operates grocery stores throughout Afghanistan. Company A files its tax return for the 1387 year and pays the tax shown as due on the return on the last day of Jawza in the year 1388. In calculating its tax liability, however, Company A claimed a deduction for the cost of electric generators that it purchased. The electric generators are used to provide electric lighting and heating in the grocery stores that Company A owns. The cost of the electric generators should not have been deducted. Instead, the cost of the electric generators should have been depreciated over time. Because of this error, Company A's income tax return is incorrect. Company A owes more income tax to the Ministry of Finance than the tax return shows. Company A is not subject to the additional tax under Article 107, because Company A filed its tax return on time. Company A may be subject to the additional tax under Article 109, however, if Company A did not have reasonable justification for claiming the cost of the generators as a deduction.*

Additional income tax where tax was not withheld

- Article 108
- (1) A person who fails to withhold tax as required under the provisions of this Law which apply to payments of dividends, interest, royalties, wages, salaries, rents, commissions, and similar incomes without reasonable cause shall pay additional income tax of 20 per cent of the tax that should have been withheld.
 - (2) A person who fails to withhold tax as required under paragraph (1) of this Article as a result of gross negligence or disregard shall pay additional income tax of 40 per cent of the tax that should have been withheld.
 - (3) A person who deliberately fails to withhold tax as required under paragraph (1) of this Article shall pay additional income tax of 100 per cent of the tax that should have been withheld.
 - (4) A person who fails to withhold tax with the intent of evading payment of tax under paragraph (1) of this Article, in addition to the payment of an additional tax under paragraph (3) of this Article, shall be guilty of an offence and is liable upon conviction by a court to a fine not exceeding 125,000 afghanis or imprisonment for a term not exceeding one year or both.

108.1 A person who fails to withhold tax as required under the provisions of this law which apply to payments of dividends, interest, royalties, wages, salaries, rents, commissions, and similar incomes without reasonable cause shall pay additional income tax of 20 per cent of the tax that should have been withheld.

Example: *Company A is an Afghan corporation that employs three individuals. The three individuals are Razique, Adib and Azziz. Because Company A employs three individuals, it is required to withhold tax from the wages of the employees. The person at the company that is responsible for making sure that the proper amounts are withheld is Faroz. Razique started working for Company A on the first day of Saratan, in the year 1387. Faroz fails to withhold tax from the wages of Razique during 1387 because Faroz believed that Razique was an independent contractor. Faroz based his belief on the fact that Razique had a written contract with Company A, but Adib and Azziz did not. When the Afghanistan Revenue Department investigates Company A, they conclude that Razique is an employee, and not an independent contractor. If Faroz's belief was reasonable, then the 20% additional tax will not apply.*

108.2 A person who fails to withhold tax as a result of gross negligence or disregard shall pay additional income tax of 40 per cent of the tax that should have been withheld. A person acts with gross negligence or disregard if the person fails to exercise the care that one would expect from a reasonable person under similar circumstances.

Example: *Company A is an Afghan corporation. Company A is involved in the construction business. Company A employs different people for different construction projects. During one month, Company A may employ 100 people. During another month, Company A may employ 300 people. The employees are all paid in cash and are paid by the person in charge of the construction job where the employee works. The person in charge of withholding tax from the wages of Company A's employees is Wahid. Wahid keeps a record of the employees that Company A has. Wahid only updates the record once per year. Because Wahid only updates the records once per year, the record fails to include 60 employees. Wahid does not instruct the person in charge of the construction site to withhold tax from every individual that is paid. The managers withhold tax from the individuals that are on Wahid's list. The managers do not withhold tax from the people that are not on Wahid's list. The Afghanistan Revenue Department learns that Company A failed to withhold tax for the 60 employees that are not on Wahid's list during the year 1388. Company A's actions were not reasonable. The fact that Wahid only updates his list once per year and the fact that Wahid fails to properly instruct the managers of the construction sites who are actually paying the employees is not the type of behavior that a reasonable person would engage in. The 40% additional tax should apply.*

108.3 A person who deliberately fails to withhold tax shall pay additional income tax of 100 per cent of the tax that should have been withheld.

Example: *Company A is an Afghan corporation. Company A employs 100 people in its construction business. Ten of Company A's employees are permanent employees that work during the entire year. The remaining employees are temporary employees that only work when Company A has projects for them to work on. Company A was audited for the first time for the tax year 1387. Company A had withheld tax from its permanent employees, but did not withhold tax from its temporary employees. Company A was required to pay the withholding tax due for its temporary employees during 1387 and was advised that Company A was required to continue withholding tax from the wages of its temporary employees in the future. Company A was audited again for its tax year 1390. Again, Company A had withheld taxes from its permanent employees but not its temporary employees. Company A knew that it was required to withhold tax from its temporary employees and it intentionally failed to do so. Company A should be subject to the 100% additional tax.*

108.4 A person who fails to withhold tax with the intent of evading payment of tax, in addition to the payment of additional tax under Article 108(3), can be convicted by court order to a fine of up to 125,000 Afs. or imprisonment of up to one year or both. The fine or imprisonment under Article 108(4) cannot be imposed without a court order. If the Afghanistan Revenue Department believes that the Article 108(4) additional tax should apply, the Afghanistan

Revenue Department should contact the Attorney General's Office (Saranwali) for referral to the court.

Example: *Company A is a Pakistani corporation. Company B is an Afghan corporation. Company A owns all of the issued stock of Company B. Company A has a loan outstanding to Company B. Company B pays Afs. 1,000,000 of interest on the loan during the year 1387. Company B fails to withhold 20% of the interest payment as withholding tax. Company B claimed a deduction for the full Afs. 1,000,000 interest payment that it made to Company B. When the Afghanistan Revenue Department investigates Company B for the tax year 1387, the department learns that Company A employees informed Company B employees that Company A would have to withhold 20% of the interest payment. The Company B employees instructed Company A that Company A should not withhold any portion of the interest payment. By deducting the full Afs. 1,000,000 and failing to withhold 20% of the payment, Company A and Company B attempted to reduce the amount of tax that they have to pay in Afghanistan. The Afghanistan Revenue Department should assess the 100% additional tax and can refer the case for prosecution.*

Additional income tax where tax was not paid

- Article 109
- (1) A person who fails to pay tax due under the provisions of this Law without reasonable cause shall pay additional income tax of 20 percent of the tax that should have been paid in addition to the tax payment under the Article 105 of this Law.
 - (2) A person who fails to pay tax due under the provisions of this Law as a result of gross negligence or disregard shall pay additional income tax of 40 per cent of the tax that should have been paid in addition to the tax payment under the Article 105 of this Law.
 - (3) A person who deliberately fails to pay tax due under the provisions of this Law shall pay additional income tax of 100 per cent of the tax that should have been paid in addition to the tax payment under Article 105 of this Law.
 - (4) A person who fails to pay tax due under the provisions of this Law with the intent of evading payment of tax, in addition to the payment of an additional tax under paragraph (3) of this Article, shall be guilty of an offence and is liable upon conviction by a court to a fine not exceeding 250,000 afghanis or imprisonment for a term not exceeding two years or both.

109.1 A person who fails to pay due taxes determined under the provisions of this law without reasonable cause shall pay 20 percent additional tax. This is in addition to any additional tax that may be due for the late payment of tax under Article 105.

Example 1: Azziz is an individual that earned Afs. 1,200,000 during the year 1387 in wages. Azziz's employer withheld the appropriate amount from Azziz's wages. Azziz does not owe any additional income tax as a result of his wages. Azziz also earns Afs. 100,000 of rental income from some property that Azziz owns. Azziz owes Afs. 20,000 in tax on this rental income (Afs. 100,000 x 20%). Azziz fails to pay the Afs. 20,000 on the last day of Jawza. Azziz does not have any justification for his failure to pay the tax due on the last day of Jawza. Azziz is subject to a Afs. 4,000 additional tax (Afs. 20,000 x 20%).

Azziz must pay Afs. 24,000 plus the additional tax computed under Article 105 for each day that the tax is late. If Azziz pays the tax and additional tax 10 days after the last day of Jawza, Azziz will owe a additional tax under Article 105 of Afs. 240 (10 days x 0.001 x Afs. 24,000).

Example 2: The facts are the same as in Example 1, except that Azziz failed to file his tax return and pay his tax because he was in the hospital recovering from a car accident. In this case, Azziz has a reasonable

excuse for not paying his tax on time. Azziz should not be subject to the 20% additional tax.

- 109.2 A person who fails to pay the tax determined under the provisions of this law as a result of gross negligence or disregard shall pay 40 per cent additional tax. A person acts with gross negligence or disregard if the person fails to take the care that one would expect from a reasonable person under similar circumstances.

Example: *Company A is an Afghan corporation that is engaged in the business of providing security services in Afghanistan. Company A waited until the first day of Jawza to begin collecting the information that it needed to prepare and file its tax return. It submitted this information to its accountant 5 days before the end of Jawza. Company A's accountant was not able to prepare Company A's tax return by the last day of Jawza. Company A does not have any justifiable reason for failing to pay its tax on time. Moreover, by waiting so long to begin to prepare its tax return, Company A failed to exercise the care that one would expect of a reasonable person under similar circumstances. Company A should be subject to the 40 per cent additional tax.*

- 109.3 A person who deliberately fails to pay the tax determined under the provisions of this law shall pay 100 per cent additional tax.

Example: *Wahid lives in the Wazir Akbar Khan area of Kabul. Wahid earns a wage by working for an international non-governmental organization during the tax year 1388. This non-governmental organization withholds the appropriate amount of tax from Wahid's wages and pays that amount to the government as it is required to do. Wahid also earns extra money from renting various properties to different organizations in Kabul during the tax year 1388. Wahid has seen news reports on local television about the tax law. Wahid has friends who also receive rental income and Wahid knows that they file a tax return and pay their taxes. Wahid fails to file a tax return and pay tax during the tax year 1388 because he believes that he has paid enough tax by having the tax withheld from his wages by the non-governmental organization. Wahid should be subject to the 100 per cent additional tax.*

- 109.4 A person who fails to pay the tax determined under the provisions of this law with the intent of evading payment of tax, in addition to the payment of an additional tax under Article 109(3), can be convicted by a court to a fine of up to Afs. 250,000 or imprisonment of up to two years or both. The fine or imprisonment under Article 109(4) cannot be imposed without a court order. If the Afghanistan Revenue Department believes that the Article 109(4) fine or imprisonment tax should apply, the Afghanistan Revenue Department should contact the Attorney General's Office (Saranwali) for referral to the court.

Example: *Company A is an American corporation that is engaged in construction operations in Kabul. Company A is performing*

construction activities for a private company. Company A is not exempt from Afghan tax under any applicable treaty or international agreement. Company A operates in Afghanistan for three years. The Afghanistan Revenue Department decides to investigate Company A in the tax year 1388. During the investigation, the Afghanistan Revenue Department obtains electronic mail correspondence from Company A's Kabul office to its primary shareholder. The correspondence indicates that the Company A personnel knew that Company A was obligated to pay income tax and business receipts tax in Afghanistan. The correspondence indicates that the primary shareholder told Company A personnel not to pay the tax, because Company A would only be operating within Afghanistan for a short period of time. The Afghanistan Revenue Department should refer this case to the prosecutor's office for prosecution before the court.

Additional income tax related to Tax Identification Numbers

- Article 110 (1) A person required to have a Tax Identification Number under Article 91 of this Law who fails to apply for a Tax Identification Number without reasonable cause shall pay additional income tax of 5,000 afghanis if the person is a natural person or 20,000 afghanis if the person is a legal person.
- (2) A person required to have a Tax Identification Number under Article 91 of this Law who fails to apply for a Tax Identification Number as a result of gross negligence shall pay additional income tax of 15,000 afghanis if the person is a natural person or 50,000 afghanis if the person is a legal person.
- (3) A person required to have a Tax Identification Number under Article 91 of this Law who deliberately fails to apply for a Tax Identification Number shall pay additional income tax of 30,000 afghanis if the person is a natural person or 100,000 afghanis if the person is a legal person.

110.1 A person required to have a Tax Identification Number under Article 91 of this Law who fails to apply for a Tax Identification Number without reasonable cause shall pay additional income tax of 5,000 Afs. if the person is a natural person or 20,000 Afs. if the person is a legal person.

Example 1: *Asiyeh lives in Badakhshan province. Asiyeh lives in a small village. Asiyeh is employed by an international non-governmental organization. Asiyeh works as a mid-wife in her village. She assists women who are giving birth. Asiyeh's employer withholds a portion of Asiyeh's wages as it is required to do under the law for the tax year 1388. Under Article 91, Asiyeh is required to have a taxpayer identification number in the tax year 1388. Asiyeh is illiterate and has failed to obtain and fill out the proper forms to obtain a taxpayer identification number. Her employer has not provided her with any information about obtaining a taxpayer identification number. Moreover, Asiyeh would be required to travel for days to find the office that has the forms that will enable her to obtain a taxpayer identification number. When the Afghanistan Revenue Department investigates Asiyeh and informs Asiyeh that she needs a taxpayer identification number, Asiyeh agrees to sign the correct forms and obtain her number. Asiyeh has a reasonable cause for failing to obtain a taxpayer identification number.*

Example 2: *Sarika lives in Kabul province. Sarika works for an international non-governmental organization. Sarika works as a mid-wife. She assists women who are giving birth. Sarika's employer withholds tax from Sarika's wages during the tax year 1388. Sarika asks her employer why the employer is withholding tax. The employer informs Sarika that she is subject to income tax and that she needs to obtain a*

taxpayer identification number. In Kabul province, Sarika has access to the internet from which she can obtain tax forms. She is also able to travel to the Ministry of Finance offices in Kabul from which she can obtain tax forms. Sarika does not obtain a tax identification number, because it will cost money to use the internet and it will cost money to travel by taxi to the Ministry of Finance. Sarika does not have a reasonable justification for not obtaining a taxpayer identification number. Sarika is subject to the Afs. 5,000 additional tax.

- 110.2 A person required to have a Tax Identification Number under Article 91 of this Law who fails to apply for a Tax Identification Number as a result of gross negligence shall pay additional income tax of 15,000 Afs. if the person is a natural person or 50,000 Afs. if the person is a legal person. A person acts with gross negligence if the person fails to act with the same degree of care that one would expect from a reasonable person under similar circumstances.

Example: *Wahid works for a security firm in Kabul. Wahid has access to the internet. Wahid has seen the Ministry of Finance website. Wahid passes the Ministry of Finance every day on his way to work. Wahid's employer withholds tax from Wahid's pay. Wahid's employer advises Wahid that he needs to obtain a taxpayer identification number. Wahid's employer provides Wahid the forms that Wahid needs to complete in order to obtain a taxpayer identification number. Wahid does not obtain a taxpayer identification number because he believes he has more important things to do. Wahid's behavior is not the type of behavior one would expect from a reasonable person under similar circumstances. Wahid should be subject to the Afs. 15,000 additional tax.*

- 110.3 A person required to have a Tax Identification Number under Article 91 of this Law who deliberately fails to apply for a Tax Identification Number shall pay additional income tax of 30,000 Afs. if the person is a natural person or 100,000 Afs. if the person is a legal person.

Example: *Company A is an Afghan corporation. Company A conducts construction operations in Afghanistan. Company A has been in Afghanistan during the tax years 1388 and 1389. Company A believes that its operations in Afghanistan are almost finished. Company A does not believe that it will receive any construction contracts in the future. Company A knows that it is required to obtain a taxpayer identification number but decides that it will not do so. When the Afghanistan Revenue Department investigates Company A, it learns that Company A has not paid its income tax liability for two years. Company A has not withheld tax from its employees' wages. Company A deliberately avoided obtaining a taxpayer identification number in order to hide its activities from the Afghanistan Revenue Department. Company A should be subject to the Afs. 100,000 additional tax.*

Offenses committed by taxation officers

- Article 111 (1) A taxation officer who discloses confidential information with the intent of any direct or indirect benefit from the disclosure, or any person who assists a taxation officer to disclose confidential information, is guilty of an offence and is liable upon conviction by a court to a fine not exceeding 125,000 afghanis or imprisonment for a term of up to one year, or both.
- (2) A taxation officer who misuses their position in any unauthorized way for the purpose of direct or indirect financial or other benefits is guilty of an offence and is liable upon conviction by a court to a fine not exceeding 225,000 afghanis or imprisonment for a term not exceeding three years, or both.

111.1 Where a taxation officer discloses confidential information for the purpose of any direct or indirect benefit, or other persons assist them in that regard, those persons may be convicted and liable to pay up to 125,000 Afs. or be imprisoned for up to one year, or both. The fine or imprisonment cannot be imposed without an order from a court. If Afghanistan Revenue Department personnel believe that Article 111(1) should apply, they should refer the matter to the Ministry of Justice for prosecution.

Example: *Feroz works in the large taxpayer office of the Afghanistan Revenue Department. During an investigation of Company A, Feroz learns about Company A's revenue and profit figures. Company A's primary competitor in Afghanistan is Company B. Feroz agrees to sell the information he has learned about Company A to Company B for Afs. 200,000. This case should be referred to the Ministry of Justice for prosecution.*

111.2 Where a taxation officer misuses their position for the purpose of direct or indirect financial or other benefit without official permission of the authorities, that person may be convicted and liable to pay up to 225,000 Afs. or be imprisoned for up to three years, or both. The fine or imprisonment cannot be imposed without an order from a court. If Afghanistan Revenue Department personnel believe that Article 111(2) should apply, they should refer the matter to the Ministry of Justice for prosecution.

Example: *Wahid is an employee of the Kabul Moustafiat. Company A files its tax return with the Kabul Moustafiat. Wahid reviews the tax return. Wahid tells Company A that if Company A pays him Afs. 30,000, that Wahid will agree to reduce the amount of profits that are shown on the Company A tax return. This case should be referred to the Ministry of Justice for prosecution.*

Authority for collection of additional tax

Article 112 Additional tax imposed under the provisions of this Chapter will be collected by Ministry of Finance tax offices.

112.1 Taxpayers who are required to pay additional tax should pay that tax in the same manner as payments of the tax itself. In accordance with Regulation 93.1, taxpayers should pay additional tax to an authorized bank. The Revenue Department will arrange to collect copies of the additional tax payment form from the authorized bank and will treat those payments as having been made at a tax office.

CHPATER XVII

FINAL ARTICLES

Article 113 – Article 117

Provision of forms and rulings

- Article 113 (1) The Ministry of Finance is required to provide forms that are necessary for the purpose of determining and collecting tax according to the Law.
- (2) The Ministry of Finance may issue an income tax manual and separate public and private rulings regarding income tax for the better administration of the provisions of this Law.

113.1 The Afghanistan Revenue Department of the Ministry of Finance is responsible for the administration of the income tax law. As part of that responsibility, the Afghanistan Revenue Department has developed forms, and will continue to develop and update forms, as required by taxpayers in order that taxpayers may comply with the income tax law.

Forms are available from the mustofiat in each province. Forms are also available from the Afghanistan Revenue Department, Ministry of Finance, Kabul.

113.2 The authority for the Ministry of Finance to issue this Income Tax Manual is provided by this Article. The purpose of the Income Tax Manual is to clarify the interpretation and application of the income tax law. It can however only provide general guidance. It cannot be expected to cover every possible circumstance for all taxpayers.

113.3 For the Ministry of Finance position on matters not covered by the Income Tax Law, there are two courses of action. The Ministry of Finance (through the Afghanistan Revenue Department) may issue public rulings and private rulings.

113.4 A public ruling is the Ministry of Finance's position, in writing, regarding the application of the income tax law to an issue which affects many taxpayers. For example, the Ministry of Finance has issued a public ruling regarding the termination of 'tax holidays' under the Law on Domestic and Foreign Private Investment in Afghanistan (Public Ruling 1383/4). The Ministry of Finance will continue to issue public rulings on matters of importance as and when required. It remains the sole discretion of the Ministry of Finance to decide in what circumstances to issue a public ruling and the position it takes regarding the interpretation and application of the law.

113.5 A private ruling is the Ministry of Finance's position, in writing, regarding the application of the income tax law to an issue which affects a certain, identified person or a group of certain, identified persons. The Ministry of Finance will provide its position on the application of the income tax law on the facts, supported by documentary evidence where appropriate, provided by the applicant for the private ruling. A private ruling can only be issued on the interpretation of the income tax law. This process cannot be used to

clarify the application of other laws. Nor can it be used to clarify the tax liability of anyone other than the applicant(s). If persons other than the applicants wish to obtain advice regarding their tax liability they must apply for a private ruling in their own name(s).

- 113.6 In both cases of public rulings and private rulings, the Ministry of Finance will be bound by its interpretation of the law.

For further information on the public and private rulings process, reference should be made to the Public Ruling titled 'The Public and Private Rulings System'.

Non issuance of licenses

Article 114 Where natural or legal persons have not paid their tax due by the due date according to the provisions of this Law, the Ministry of Finance may officially inform those government agencies and departments which have the authority to issue licenses to not renew their licenses. The licenses of persons may be issued only when they have documents from the Ministry of Finance to indicate they have fulfilled their tax obligations and submitted them to the relevant office.

114.1 Taxpayers are generally required to request and receive a tax clearance certificate (or similar approval) from the Ministry of Finance before being permitted to renew any license they are required to have from government departments and other agencies.

114.2 Where the Ministry of Finance has specifically identified taxpayers as having outstanding tax obligations, the Ministry of Finance may inform licensing authorities of those taxpayers and the licensing authority will not renew licenses until approval is given by the Ministry of Finance. Taxpayers will be required to receive a tax clearance certificate or similar approval from the Ministry of Finance for presentation to the relevant licensing authority before a license may be renewed.

Requirements for entitlement to exemption

- Article 115 (1) Approved enterprises which have not met the requirements of the provisions of the Law on Domestic and Foreign Private Investment in Afghanistan published in official gazette no (803) dated 1381/6/20 and other related laws are no longer entitled to income tax exemption under the provisions of that Law from 21 June 2004 (1 Saratan 1383).
- (2) Approved enterprises according to the provisions of the Law on Domestic and Foreign Private Investment in Afghanistan mentioned in paragraph (1) of this Article which have commenced business activities prior to 22 November 2003 (1 Kawos 1382) may benefit from the income tax exemptions mentioned in the investment law only if they have complied with and continue to comply with the provisions of that law and other related laws.
- (3) If an approved enterprise granted tax exemption under the provisions of the Law on Domestic and Foreign Private Investment in Afghanistan holds capital assets on the date the exemption ends as a result of paragraph (1) of this Article or the date the tax exemption expires, the remaining undepreciated value of the capital assets on that date will be treated as the cost of those capital assets.

115.1 The Law on Domestic and Foreign Private Investment 1381 provided exemption for 'approved enterprises' from taxation, including income tax, for periods for 4, 6, 8 and in special cases more than 8 years. Subsequent amendments to the Income Tax Law (1965) brought an end to the continued granting of tax holidays which were contrary to the income tax law. No tax holidays granted from 21 June 2004 will be recognized by the Ministry of Finance. Of those tax holidays granted before 21 June 2004, only those 'approved enterprises' which have meet two requirements may be entitled to continue their tax holiday until its expiration. The two requirements are:

1. the approved enterprise must have commenced business activities prior to 22 November 2003, the date that the Afghanistan Investment Support Agency took over responsibility for registration of private investment from the Ministry of Commerce; and
2. the approved enterprise must have complied with, and continues to comply with the provisions of the Law on Domestic and Foreign Private Investment 1381 (or its successor law) and the provisions of related laws.

115.2 Where the tax holiday for an approved enterprise ceased from 21 June 2004, the approved enterprise will become liable to income tax from that date. For the purposes of calculating a deduction for depreciation of assets held at that date, the remaining undepreciated value of those assets will be treated as the cost of those assets.

Example:

Kabul Constructions is an approved enterprise with a tax holiday which ended 21 June 2004. On 21 June 2003, it had purchased machinery for 100,000 Afs. which has a useful life of 5 years. At the time that the tax holiday ended, the machinery will have been used for one year. The depreciation will be $1 \text{ year} / 5 \text{ years} \times 100,000 \text{ Afs.} = 20,000 \text{ Afs.}$ The undepreciated value of the machinery as at the end of the tax holiday will be the cost of the machinery less the depreciation to 21 June 2004 ie $100,000 - 20,000 = 80,000$. Kabul Construction will be entitled to claim a deduction for depreciation for the use of the machinery from 21 June 2004 on the basis that the machinery cost 80,000 Afs. at that date.

Kabul Constructions may calculate depreciation on a straight line basis over the asset's useful life in accordance with paragraph 7 of Article 18 (1) or on an accelerated basis under Article 47 if Kabul Constructions satisfies the requirements of that Article.

For guidance on the Ministry of Finance position on the transition from tax holidays to tax concessions in the form of accelerated depreciation and unlimited loss carry forward, reference should be made to the Public Ruling titled 'Income Tax: Tax Holidays, Exemptions and Concessions for Investors'.

Primacy of Income Tax Law

- Article 116 (1) In the event of any conflict between contracts, agreements, and provisions of other laws with the provisions of the Income Tax Law, the Income Tax Law shall prevail.
- (2) International contracts and agreements entered into by the Islamic Republic of Afghanistan with foreign countries or United Nations agencies are excluded from the provisions of the paragraph (1) of this Article.

116.1 Paragraph (1) of Article 116 asserts the primacy of the Income Tax Law over contracts, agreements or other laws. If a contract, agreement or another law makes provisions for income taxation which are different to the Income Tax Law, then those provisions will be considered to have no effect and the provisions of the Income Tax Law shall apply.

116.2 In the normal course of government administration, a public official e.g. a Minister of a government Ministry will enter into contracts or agreements. Although the Minister may have the authority to purchase goods or services, the Minister cannot override the laws of Afghanistan on his/her authority alone. Where these contracts or agreements presume to provide special tax treatment inconsistent with the Income Tax Law, those provisions of the contract (but not necessarily other provisions) will be ineffective.

Example: *A government Minister, on behalf of a Ministry, enters into an agreement for the construction of a building. The agreement states that the building contractor will be exempt from income tax. Unless the Minister is acting with the authority of the Government of Afghanistan, or the agreement is subsequently ratified by the Government of Afghanistan, the agreement will not override the income tax law. The tax exemption granted by the Minister will not be effective. The Income Tax Law will apply.*

116.3 Paragraph (2) of Article 116 recognises exceptions to the statement that contracts and agreements which provide special tax treatment cannot override the Income Tax Law. Those exceptions must meet the pre-condition that the contract or agreement is entered into with the Islamic Republic of Afghanistan.

One exception is the situation where contracts or agreements are entered into by the Islamic Republic of Afghanistan with foreign countries. Multilateral organizations (such as the European Union or European Community) comprised of various member countries shall be considered foreign countries for this purpose.

Another exception is the situation where contracts or agreements are entered into by the Islamic Republic of Afghanistan with the United Nations

or its agencies. Examples of agencies of the United Nations include United Nations Children's Fund (UNICEF), United Nations Development Program (UNDP), United Nations High Commission for Refugees (UNHCR), United Nations Office for Special Projects (UNOPS), the World Bank group, the International Monetary Fund etc.

- 116.4 The Ministry of Finance shall publish guidelines, after consultation with the Ministry of Foreign Affairs and Ministry of Justice, to address the circumstances pursuant to which a treaty, contract, or other agreement shall be considered approved in accordance with Article 116(2) and/or Article 90 of the Constitution for the Islamic Republic of Afghanistan.

Enforcement date

Article 117 This Law shall come into force from the date that it is signed and shall be published in the Official Gazette. After its enforcement, the Income Tax Law published in Official Gazette number 25 dated 29 Saor 1344 (1965), amendments mentioned in decree number (52) dated 27 Hoot 1383 (17 March 2005) and other amendments, attachments and provisions contrary to this Law are cancelled.

117.1 Presidential Decree number 95 of 14 November 2005 provides that while most Articles in this Law came into effect on 14 November 2005 (the date of signing), the following provisions have different dates of effect:

- (1) Articles 8(5), 13(2), 13(3), 18(2)3, 42(2) and 93(5) apply from 21 March 2006 (1 Hamal 1385)
- (2) Articles 58 and 60 apply from 23 September 2005 (1 Mizan 1384)
- (3) Articles 70(1) and 71(1) apply from 21 March 2005 (1 Hamal 1384)
